

ACCOUNTABILITY TO AMERICA



DEPARTMENT OF THE NAVY WORKING CAPITAL FUND FISCAL YEAR 2018 ANNUAL FINANCIAL REPORT



People



Processes



Capabilities





A Sailor from the U.S. Navy Ceremonial Guard marches at the U.S. Navy Memorial in Washington, D.C., during a ceremony commemorating the 76th anniversary of the Battle of Midway. (U.S. Navy photo by Senior Chief Musician Stephen Hassay/Released)

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Fiscal Year 2018 Department of the Navy Working Capital Fund Annual Financial Report



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Sailors rappel from an MH-60S Seahawk helicopter to a flight deck. (U.S. Navy photo by Petty Officer 3rd Class Alex Corona)



The Department of the Navy (DON) is focused on increasing warfighting readiness because it is our duty to deliver a combat-ready naval force which can prevail anytime, anywhere. Our organization has developed other vital, unparalleled capabilities – deterrence, humanitarian disaster relief, and maritime security. But at the core of the Navy and Marine Corps culture, we are warriors whose core mission is to be ready to fight now, and to win that fight. I have established priorities to enhance our readiness and improve our lethality. As I stated in the DON's Fiscal Year 2018 Annual Financial Report, "Accountability to America," these priorities center on people, capabilities, and processes, and will be achieved by focusing on speed, value, results, and partnerships. Readiness, lethality, and modernization are the requirements driving these priorities.

The ability to accomplish our mission successfully relies on the Navy and Marine Corps team – Sailors and Marines, active duty and reserve, our civilian teammates, and families. We rely on their superior talent, recruiting the most promising workforce for the future, and

making strategic investments in training and retention initiatives.

As we build our capabilities to fight when needed and to challenge rivals, we must respond on all fronts, to include research and development, rapid prototyping, accelerated learning, and partnership with industry. These efforts will be built on shared risks and shared benefits. We are now working with industry in a true partnership to achieve a sustainable acquisition process that will provide solutions to the security challenges we face so we remain the world's premier Navy. Additionally, we are determined to work with our industry partners to implement their lessons learned in order to be better informed customers for our suppliers.

The DON is actively reforming business processes and driving efficiencies to increase speed, value, and support to the warfighter. We are identifying and clearing constraints caused by burdensome policies and regulations and are increasingly adopting agile business models and technologies to support our need for urgency. Layers of overhead are being removed and organizations are being flattened to return decision-making authority further down the command structure. We must improve our processes across the board and aggressively identify and eliminate waste.

We are in the process of conducting a full audit of both the Navy and Marine Corps for the first time in the history of the DON. The audit is not just a financial tool, it is a management tool forcing us to evaluate how effective we are in both small and large ways. For example, the audit process has already revealed that the complexity of our 1,100 center distribution network is too great for effective management, and this in turn leads to challenges with knowing the location and condition of all the parts and equipment we own. It has also shown that we move money internally too many times before it arrives in the hands of the folks that actually perform the work.

The audit will expose critical deficiencies before they become negative consequences, as well as help to develop strategic solutions to improve the way we go about our business. The audit presents an opportunity to realign our people, capabilities, and processes to maximize our strengths, minimize our weaknesses, seize opportunities, and mitigate threats. Detailed discussion of identified weaknesses and ongoing remediation efforts are disclosed in the DON Statement of Assurance within the Management's Discussion and Analysis section.

We are devoted to gaining full value from every taxpayer dollar spent on Defense. We owe it to the American public to ensure that funds are being used to the best of our abilities, that's why I've made it clear that conducting the audit and remediating the deficiencies with a sense of urgency is a top departmental priority. The audit, along with other process changes, will instill credibility inside and outside of the DON and create trust between us and the public. The value of the audit won't be measured in profit, but in lethality and readiness.

A handwritten signature in blue ink, which appears to read "R. Spencer".

RICHARD V. SPENCER
Secretary of the Navy



An EA-18G Growler flies over a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist Seaman Michael A. Colemanberry/Released)

Overview

The United States Navy (USN) traces its lineage back to the days of the Continental Navy during the Revolutionary War, when it was established by a resolution of the Continental Congress on October 13th, 1775. The United States Navy was ratified by Congressional Act as the Department of the Navy (DON) on April 30th, 1798 with a second uniformed service, the United States Marine Corps (USMC), incorporated into the DON in 1834. The DON remained its own standalone Department until the National Security Act of 1947, at which time the DON, alongside the United States Army and United States Air Force, became component services of the Department of Defense (DoD).

The Navy's core responsibilities are to deter aggression and, if deterrence fails, win the Nation's wars. The Navy employs the global reach and persistent presence of forward-stationed and rotational forces to secure the nation from direct attack, assure joint operational access, and retain global freedom of action. Along with global partners, the Navy protects the maritime freedom that is the basis for global prosperity and fosters and sustains cooperative relationships with an expanding set of allies and international partners to enhance global security.

The DON Working Capital Fund (WCF) is a revolving fund and is reimbursed for the goods, services, and

infrastructure provided to the DON and other DoD customers based on a relationship between operating units and DON WCF support organizations. The Navy uses these funds to execute its mission. DON WCF activities strive to break even over the budget cycle. DON WCF has five lines of business: Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation. The principal statements included in this annual financial report present the consolidated financial position and results of operations for all the activities included in the DON WCF.

The DON fiscal year (FY) 2018 objectives and goals center on three key priorities: People, Processes, and Capabilities. The focus is to restore program balance, sustain global demand for naval forces, continue improving readiness, recapitalize and modernize naval forces, address the competitive operational environment, improve cyber resiliency, and focus on responsible military spending. These FY 2018 efforts will build capability and improve lethality in FY 2019 and beyond. Success in these areas will provide real benefits to the United States in fulfillment of the DON's responsibilities to maintain a capable Navy and Marine Corps presence. It will increase the effectiveness and efficiency of the entire Department,

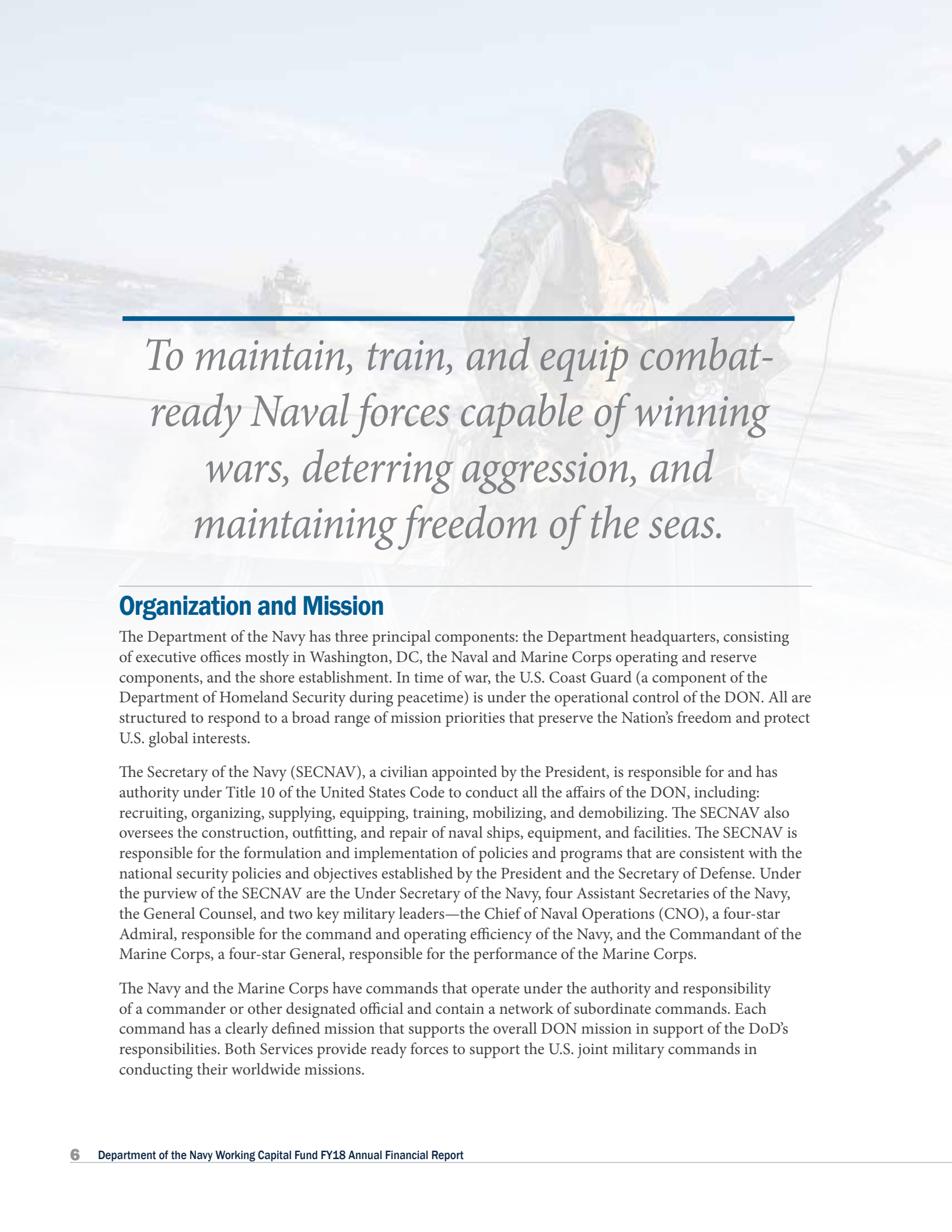
improve the lives of Sailors and Marines, and result in greater security for the United States. The Strategic Management section of this report highlights some of the significant organizational activities and accomplishments from the past year that support the DON's objectives and goals.

The DON continues to move forward and make significant progress toward full financial statement auditability and overall financial improvement. In FY 2018, the DON WCF completed its first full financial statement audit. The audit yielded various Notices of Findings and Recommendations, a Flag Officer or Senior Executive was assigned to direct the remediation of each finding. The Navy continues to widen the circle of accountability for making improvements

in its culture. The DON is meeting hurdles head-on and continues to progressively change business environments whereby improvements are incorporated into permanent work processes. The result will be a strengthened stewardship for public funds, institutionalized by performing effective internal controls over business processes and system; and by making business policies and procedures more precise and compliant with accounting standards. The DON is committed to promoting a business culture in which all participants understand their respective roles in achieving and sustaining financial auditability, from senior leaders down to the business managers who support the warfighting forces each day.



Sailors heave a line during a replenishment-at-sea with a dry cargo and ammunition ship. (U.S. Navy photo by Mass Communication Specialist Seaman Apprentice Ellen Sharkey/Released)



To maintain, train, and equip combat-ready Naval forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

Organization and Mission

The Department of the Navy has three principal components: the Department headquarters, consisting of executive offices mostly in Washington, DC, the Naval and Marine Corps operating and reserve components, and the shore establishment. In time of war, the U.S. Coast Guard (a component of the Department of Homeland Security during peacetime) is under the operational control of the DON. All are structured to respond to a broad range of mission priorities that preserve the Nation's freedom and protect U.S. global interests.

The Secretary of the Navy (SECNAV), a civilian appointed by the President, is responsible for and has authority under Title 10 of the United States Code to conduct all the affairs of the DON, including: recruiting, organizing, supplying, equipping, training, mobilizing, and demobilizing. The SECNAV also oversees the construction, outfitting, and repair of naval ships, equipment, and facilities. The SECNAV is responsible for the formulation and implementation of policies and programs that are consistent with the national security policies and objectives established by the President and the Secretary of Defense. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations (CNO), a four-star Admiral, responsible for the command and operating efficiency of the Navy, and the Commandant of the Marine Corps, a four-star General, responsible for the performance of the Marine Corps.

The Navy and the Marine Corps have commands that operate under the authority and responsibility of a commander or other designated official and contain a network of subordinate commands. Each command has a clearly defined mission that supports the overall DON mission in support of the DoD's responsibilities. Both Services provide ready forces to support the U.S. joint military commands in conducting their worldwide missions.

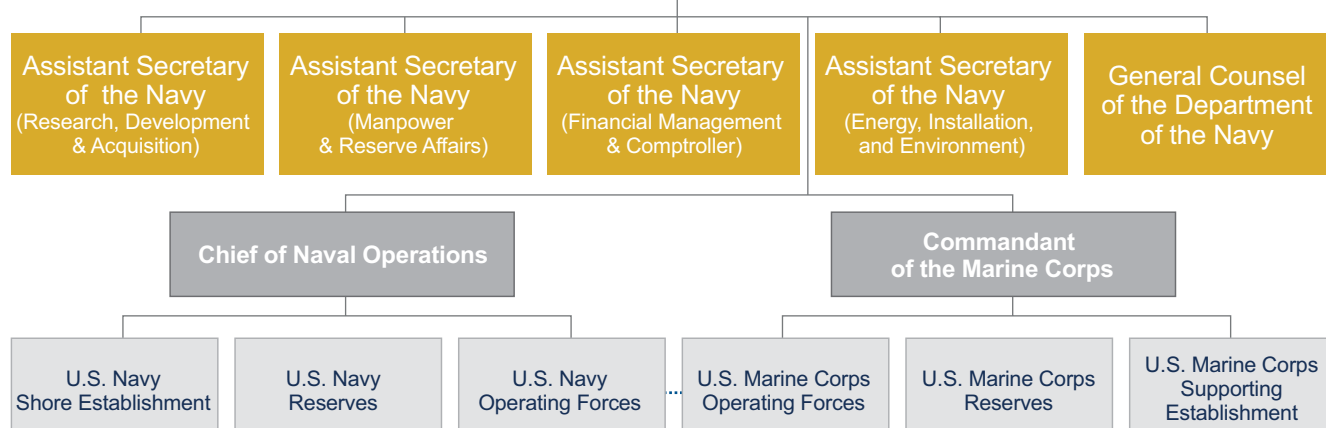


Established 30 April 1798

Title 10 U.S. Code, Section 5061

SECRETARY OF THE NAVY

UNDER SECRETARY OF THE NAVY



**Dashed line signifies collaboration of the U.S. Navy and the U.S. Marine Corps operating forces.*

DON WORKING CAPITAL FUND ORGANIZATIONAL DESCRIPTION

The DON WCF acts as the in-house general contractor in the execution of the DON's strategic mission. The DON WCF accepts appropriated funding from Congress as an initial corpus, but otherwise charges customers on a reimbursable basis to recoup the full cost of operations. Congressional appropriations to WCFs do occur annually to restore the corpus due to uncovered costs, capital investments, or increased "float" resulting from the lag between vendor payments and customer collections.

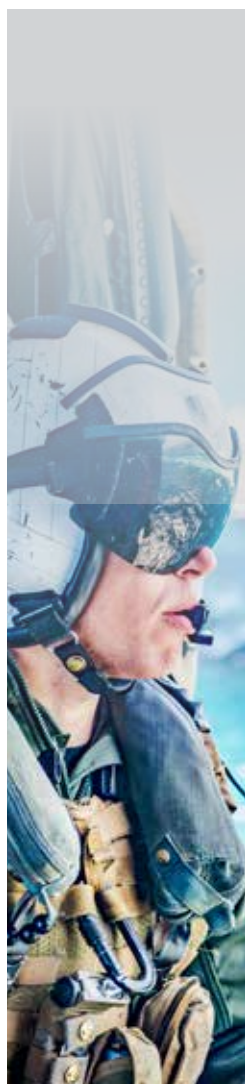
The WCF entities within the DON accept orders from customers (e.g. operating forces, readiness commands, federal agencies, or other WCFs) and in turn, the WCFs finance the cost of performing work. Work is then performed (either by internal resources, commercial

vendors, or other third parties) to produce goods or provide services for customers. The WCF then bills customers for the costs of those services or goods in amounts that are intended to recapture the full cost of labor, materials, indirect costs, and overhead incurred in the performance of work.

The DON WCF, unlike general funds, prepare budget estimates and set rates annually to ensure costs are fully recovered. Working capital funds can also operate in the absence of an appropriations act, as WCF activities can utilize funded carry-over provided that the WCF's cash balance is sufficient to operate.



An Aviation Boatswain's Mate moves an EA-18G Growler in a hangar bay. (U.S. Navy photo by Mass Communication Specialist 3rd Class Kaysee Lohmann/Released)



DON Working Capital Fund Component Reporting Entity

The CFO Act of 1990 (Pub. L. No. 101-576), as amended by the Government Management Reform Act (GMRA) of 1994 (Pub. L. No. 103-356), permits the Office of Management and Budget (OMB) to designate selected components of CFO Act Agencies (to include the Department of Defense) as required reporting entities. OMB Bulletin 19-01 remains in effect for FY 2018 and has designated the DON working capital fund as a required reporting entity.

The DON WCF is considered a Component Reporting Entity (CRE), in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 47, "Reporting Entity." A CRE is a broadly used term referring to reporting entities within larger reporting entities. The DON WCF organizationally defines itself as a CRE based on the accountability perspective allowable under SFFAS 47 (i.e. org charts, performance monitoring, and operating plans). Within the construct of SFFAS 47, the DON WCF CRE is aligned to seven of the DON's budget submitting offices (BSOs) and the U.S. Marine Corps, identified and described below.

The Navy aligns budget accounts to the DON WCF CRE based on Statements of Federal Financial Accounting Concepts (SFFAC) No. 2, "Entity and Display." The DON has elected to use the Department Code 97, Treasury Account Symbol 4930.002: *Defense Working Capital Fund*, Navy as the appropriation that comprises the DON WCF CRE.

The 4930.002 appropriation is under the administrative control of seven BSOs noted below and the USMC, and this represents the scope of the CRE represented in the *Department of the Navy Working Capital Fund Fiscal Year 2018 Annual Financial Report* and financial statements.

Consolidating Entities of the DON Working Capital Fund

Seven DON BSOs and the USMC's Logistics Command (LOGCOM) operate working capital fund activities. Those WCF activities are consolidated to comprise the DON working capital fund financial statements. The seven DON BSOs, their WCF activities, and USMC's LOGCOM are further described below.

DON Working Capital Fund BSOs and Activities



NAVAL FACILITIES ENGINEERING COMMAND

The Naval Facilities Engineering Command (NAVFAC) delivers and maintains quality, sustainable facilities; acquires and manages capabilities for the Navy's expeditionary combat forces; provides contingency engineering response; and enables energy security and environmental stewardship. NAVFAC is a global organization made up of a Civil Engineer Corps consisting of officers, civilians, and contractors, who serve as engineers, architects, contract specialists, and professionals to manage the planning, design, construction, contingency engineering, real estate, environmental, and public works support for Navy shore facilities around the world. As a major Navy systems command and an integral member of the Navy and Marine Corps, NAVFAC delivers timely and effective facilities engineering solutions worldwide. NAVFAC has 13 component commands and is headquartered at the Washington Navy Yard in Washington, DC. NAVFAC acts for and exercises the authority of the Navy Acquisition Executive to manage assigned programs and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development and acquisition.

NAVFAC operates and reports the below activities to the DON WCF financial statements. NAVFAC operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **BASE SUPPORT: THE NAVAL FACILITIES ENGINEERING SERVICE CENTER** - The Naval Facilities Engineering Service Center (FEC) provides engineering, design, construction, technology implementation, and management support worldwide to shore, ocean, and waterfront activities and to amphibious and expeditionary operations. The center also provides environmental, energy, and utility services. The FECs are operated by the NAVFAC BSO.
- **BASE SUPPORT: ENGINEERING AND EXPEDITIONARY WARFARE CENTER** - The Engineering and Expeditionary Warfare Center (EXWC) delivers specialized engineering and technology solutions that support sustainable facilities and provides logistics and expeditionary systems support for Navy combat force capabilities. The EXWC is operated by the NAVFAC BSO.



NAVAL AIR SYSTEMS COMMAND

The Naval Air Systems Command (NAVAIR) is focused on research, design, development, and systems engineering; acquisition management; test and evaluation; training facilities and equipment; repair and modification; and in-service engineering and logistics support of naval aviation aircraft and weapon systems operated by Sailors and Marines. NAVAIR is organized into eight “competencies” or communities of practice including Program Management, Contracts, Research and Engineering, Test and Evaluation, Logistics and Industrial Operations, Corporate Operations, Comptroller, and Counsel. NAVAIR provides support (people, processes, tools, training, mission facilities, and core technologies) to Naval Aviation Program Executive Officers and their assigned program managers, who are responsible for meeting the cost, schedule, and performance requirements of their assigned programs. NAVAIR is the principal provider for the Naval Aviation Enterprise, which maintains top combat effectiveness by smartly managing precious resources and attack readiness degraders, while collaborating across organization boundaries to deliver ready forces where and when they are needed. NAVAIR is headquartered in Patuxent River, MD with military and civilian personnel stationed at eight locations across the continental United States and one site overseas. NAVAIR acts for, and exercises the authority of the Navy Acquisition Executive to manage assigned programs and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development and acquisition.

NAVAIR operates and reports the below activities to the DON WCF financial statements. NAVAIR operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **RESEARCH AND DEVELOPMENT: NAVAL AIR WARFARE CENTERS** - The Naval Air Warfare Center (NAWC) operates the Navy's full spectrum research, test, and evaluation, in-service engineering, and Fleet support activity for naval aircraft engines, avionics, and aircraft support systems, ship/shore/air operations, weapons systems associated with air warfare, missiles and missile subsystems, aircraft weapons integration, and airborne electronics warfare systems. The center also operates the department's air, land, and sea test ranges. The NAWCs are operated by the NAVAIR BSO.
- **DEPOT MAINTENANCE: FLEET READINESS CENTERS** - The Navy's Fleet Readiness Centers (FRCs) produce quality airframes, engines, components, and support equipment, and provide services that meet Naval Aviation Enterprise's. The FRCs directly support the mission of the U.S. Navy. The three major FRCs (FRC East, FRC Southeast, and FRC West) are operated by the NAVAIR BSO.



OFFICE OF NAVAL RESEARCH

The Office of Naval Research (ONR) has been developing cutting-edge science and technology (S&T) for U.S. naval forces for more than 70 years. Long recognized as a leading sponsor of S&T research through partnerships across government, industry, and academia, ONR manages short-, mid- and long-term scientific investments, serving as the “venture capital” for the Department of the Navy. ONR leads the Naval Research Enterprise, comprised of ONR Headquarters, the Naval Research Laboratory, the Office of Naval Research Global and PMR-51 (office of special projects). ONR is constantly changing to keep pace with technology innovation and to accelerate results. Under the direction of Rear Admiral David Hahn, Chief of Naval Research, his strategic guidance is aligning investments to support new priorities and restructuring the business of naval science to support six core research portfolios. Together, the naval scientific and engineering community must be “first-to-field decisive capabilities.”

ONR operates and reports the below activities to the DON WCF financial statements. ONR operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **RESEARCH AND DEVELOPMENT: NAVAL RESEARCH LABORATORY** - The Naval Research Laboratory (NRL) conducts a broad-based multidisciplinary program of scientific research and advanced technological development, directed toward maritime applications of new and improved materials, techniques, equipment, and systems, and development of ocean, atmospheric, and space sciences and related technologies. The NRL is operated by the ONR BSO.



SPACE AND NAVAL WARFARE SYSTEMS COMMAND

As the Navy's Information Warfare systems command, the Space and Naval Warfare Systems Command (SPAWAR) develops, delivers, and sustains advanced cyber capabilities for the warfighters. SPAWAR, along with its system centers, space field activity, and three program executive offices, provides the hardware and software needed to execute Navy missions. With active duty military and civilian professionals located around the world and close to the fleet, SPAWAR is at the forefront of research, engineering, and acquisition, keeping the forces connected around the globe. As one of the DON's major acquisition commands, SPAWAR's realm of expertise is in information technology. SPAWAR creates products and services that transform ships, aircraft, and vehicles from individual platforms into integrated warfighting networks, delivering and enhancing information awareness among all key players. SPAWAR pursues cutting edge research and development for the Navy's growing cyberspace capabilities and provides the hardware and software that support manned and unmanned systems from seabed to space. SPAWAR is headquartered in San Diego, CA. SPAWAR acts for, and exercises the authority of the Navy Acquisition Executive to manage assigned programs and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development and acquisition.

SPAWAR operates and reports the below activities to the DON WCF financial statements. SPAWAR operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **RESEARCH AND DEVELOPMENT: SPACE AND NAVAL WARFARE SYSTEMS CENTERS** - The Space and Naval Warfare Systems Centers (SSCs) serve as the Navy's full spectrum research, development, test and evaluation, engineering, and fleet support centers for command, control, and communication systems and ocean surveillance. The centers are also responsible for integrating those systems that overarch multiplatforms. SSCs are operated by the SPAWAR BSO. The SSC is operated by the NAVFAC BSO.



NAVAL SEA SYSTEMS COMMAND

The Naval Sea Systems Command (NAVSEA) is the largest of the Navy's five systems commands and is responsible to design, build, deliver, and maintain ships and systems on-time and on-cost for the Navy. The NAVSEA workforce is comprised of military and civilian personnel in 37 activities located across the United States and around the world. Included are personnel assigned at public shipyards and regional maintenance centers where NAVSEA is the operating agent and technical authority. NAVSEA provides material support to the Navy, Marine Corps, and other agencies, as assigned, for: ships, submarines, submersibles, and other sea platforms; shipboard combat systems and components; other surface and undersea warfare and weapons systems including ship and aviation interface systems; and surface and submarine expendable ordnance. NAVSEA exercises technical and certification authority for ship, submarine, diving, and weapon systems. NAVSEA reports to the CNO and the Commandant of the Marine Corps, as appropriate, for the execution of logistics sustainment and operating forces responsibilities. NAVSEA acts for, and exercises the authority of the Navy Acquisition Executive to manage assigned programs and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development and acquisition. NAVSEA is comprised of headquarters staff and 5 affiliated Program Executive Offices (PEOs), located at the Washington Navy Yard in Washington, DC, 10 working capital fund divisions of the Naval Surface and Undersea Warfare Centers, 9 general fund field activities that includes 4 Supervisors of Shipbuilding who administer contracts with private sector shipbuilders, and numerous detachments across the United States and around the world.

NAVSEA operates and reports the below activities to the DON WCF financial statements. NAVSEA operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **RESEARCH AND DEVELOPMENT: NAVAL SURFACE WARFARE CENTERS** - The Naval Surface Warfare Center (NSWC) operates the Navy's full spectrum research, development, test and evaluation, engineering, and fleet support center for ship hull, mechanical, and electrical systems; surface ship combat systems; coastal warfare systems; and other offensive and defensive systems associated with surface warfare. The NSWCs are operated by the NAVSEA BSO.

- **RESEARCH AND DEVELOPMENT: NAVAL UNDERSEA WARFARE CENTER** - The mission of the Naval Undersea Warfare Center (NUWC) is to operate the Navy's full-spectrum research, development, test and evaluation, engineering, and fleet support center for submarines, autonomous underwater systems, and offensive and defensive weapon systems associated with undersea warfare. The NUWC is operated by the NAVSEA BSO.



U.S. FLEET FORCES COMMAND

The U.S. Fleet Forces Command (COMUSFLTFORCOM) supports both the CNO and Combatant Commanders worldwide by providing combat-ready, relevant, and sustainable Naval forces. COMUSFLTFORCOM provides operational and planning support to Combatant Commanders and integrated warfighter capability requirements to the CNO. Additionally, COMUSFLTFORCOM serves as the CNO's designated Executive Agent for thirteen Navy-wide activities and responsibilities. In collaboration with U.S. Pacific Fleet, U.S. Fleet Forces Command organizes, mans, trains, maintains, and equips Navy forces; develops and submits budgets; and executes readiness and personnel accounts to develop both required and sustainable levels of fleet readiness. COMUSFLTFORCOM is headquartered in Norfolk, VA and comprises personnel serving around the world.

COMUSFLTFORCOM operates and reports the below activities to the DON WCF financial statements. COMUSFLTFORCOM operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **TRANSPORTATION: MILITARY SEALIFT COMMAND** – The Military Sealift Command (MSC) provides efficient sea transportation, combat-ready logistics forces, and reliable special mission ships for the Department of Defense in times of peace and war. All MSC ships are crewed by civil service or contract merchant mariners, freeing active duty sailors for more traditional war-fighting assignments.

Note: MSC maintains a standalone BSO identifier for budget execution but is operationally aligned and reported alongside U.S. Fleet Forces Command.



NAVAL SUPPLY SYSTEMS COMMAND

Naval Supply Systems Command's (NAVSUP) mission is to provide supplies, services, and quality-of-life support to the Navy and Joint warfighter. With headquarters in Mechanicsburg, Pennsylvania, and employing a diverse, worldwide workforce of military and civilian personnel, NAVSUP oversees logistics programs in the areas of supply operations, conventional ordnance, contracting, resale, fuel, transportation, and security assistance. NAVSUP is also responsible for food service, postal services, Navy Exchanges, and movement of household goods. In addition to its headquarters activity, the NAVSUP enterprise includes NAVSUP Weapon Systems Support; NAVSUP Business Systems Center; Navy Exchange Service Command; and eight fleet logistics centers across the globe. NAVSUP acts for, and exercises the authority of, the Navy Acquisition Executive to manage assigned programs and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development, and acquisition.

NAVSUP operates and reports the below activities to the DON WCF financial statements. NAVSUP operations other than the below listed activities are general fund operations and consolidated in the U.S. Navy's General Fund financial statements.

- **SUPPLY MANAGEMENT: NAVSUP BUSINESS SYSTEMS CENTER** – The NAVSUP Business Systems Center (BSC) designs, develops, maintains, integrates, and implements business systems for the United States Navy, United States Department of Defense, joint service, and other federal agencies. NAVSUP BSC delivers information technology and information management solutions with specific emphasis on logistics and financial related products and services. The NAVSUP BSC is operated by the NAVSUP BSO.
- **SUPPLY MANAGEMENT: NAVSUP WEAPONS SYSTEMS SUPPORT** – NAVSUP Weapons Systems Support (WSS) provides Navy, Marine Corps, Joint and Allied Forces program and supply support for the weapon systems that keep Naval forces mission ready. NAVSUP WSS is operated by the NAVSUP BSO.
- **SUPPLY MANAGEMENT: NAVSUP GLOBAL LOGISTICS SUPPORT** – Effective April 1, 2018, NAVSUP Global Logistics Support (GLS) was disestablished and functions performed by NAVSUP GLS were realigned to NAVSUP Headquarters. Prior to its disestablishment, NAVSUP GLS provided oversight monitoring of waterfront support performance; oversight management of NAVSUP Fleet Logistics Center (FLC) operations, including contracting, fuels, global logistics services, hazardous material management, household goods movement support, integrated logistics support, material management, postal operations,

regional transportation, warehousing, logistics operations, and ammunition; and oversight management of base supply support for Navy installations worldwide.

COMPOSITION OF SUPPORT TO UNIFIED COMBATANT COMMANDS

A unified combatant command (UCC) is a DoD command that is composed of forces from at least two Military Departments and has a broad and continuing mission. These commands are established to provide effective command and control of U.S. military forces to include elements of the DON. UCCs are organized on either a geographical basis (possessing an area of responsibility) or a functional basis (providing a unique capability).

The DON WCF has only one organizational entity that operationally aligns with a UCC. The MSC, under the COMUSFLTFORCOM, provides on-time logistics, strategic sealift support, as well as specialized missions anywhere in the world as a command component of the U.S. Transportation Command (USTRANSCOM).



U.S. MARINE CORPS



The Marine Corps, established on November 10, 1775, has an FY 2018 end-strength of approximately 185,500 Active Duty Marines and 38,300 Select Reserve Marines. At any given time, approximately 30,000 Marines are forward deployed in operations supporting our nation's defense.

Headquarters, Marine Corps (HQMC) consists of the Commandant of the Marine Corps and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law and higher authority.

This includes the administration, discipline, internal organization, training, requirements, efficiency and readiness of the service. Headquarters, Marine Corps is spread throughout the Washington, DC metro area, including the Pentagon, Marine Barracks Washington, Marine Corps Base Quantico, and the Washington Navy Yard.

The Operating Forces are subdivided into four categories: Marine Corps Forces, including all Marine ground, aviation, and combat logistics; Marine Corps Reserves, Marines who support the Active Component by fielding deployable units; Security Forces, which protect key installations, vessels, units and assets of the United States Government; and Special Activity Forces, who guard United States embassies and foreign posts. The Supporting Establishment includes all bases, air stations, and installations. They assist in training, sustainment, equipping, and embarkation of deploying Marine Forces.

The USMC operates working capital fund activities for supply management and depot maintenance within the Marine Corps Logistics Command (LOGCOM). Only USMC WCF operations are a consolidating entity of the DON WCF financial statements. USMC general fund operations are presented within the USMC general fund financial statements. LOGCOM activities are described below.



MARINE CORPS LOGISTICS COMMAND

Headquartered in Albany, GA, Marine Corps Logistics Command provides worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units. The services and support provided by LOGCOM maximize supported unit readiness, synchronize distribution processes, and support Marine Corps enterprise and program-level total lifecycle management. MCLC is structured to execute its core competencies via its four subordinate commands, its Marine Expeditionary Force (MEF). Support Teams co-located with each MEF and Marine Forces Reserve Headquarters, and its liaison officers in the National Capital Region, at Marine Corps Systems Command, and the Program Executive Office- Land Systems.



Landing Craft, Air Cushion (LCAC) 58 departs the well deck of an amphibious assault ship. (U.S. Marine Corps photo by Lance Cpl. Thomas P. Miller)



Inspecting an electrical panel to prepare for a phase inspection on an F/A-18F Super Hornet. (U.S. Navy photo by Petty Officer 3rd Class Spencer Roberts)

Strategic Management

The Department of the Navy faces many demanding challenges. This is an era of great power competition, characterized by increased complexity, interdependence, and uncertainty. The global security environment continues to evolve with the reemergence of long-term strategic competition. Meanwhile, an unprecedented rate of technological change driven by artificial intelligence, robotics, autonomous systems, machine learning, and additive manufacturing are changing both society and the sea services. History has proven that new technologies and methods often create strategic inflection points that ultimately lead to changes in the character of warfare. The Navy stands at another of those points today, and naval capabilities must evolve accordingly. To keep pace, the approach to management must evolve with a focus on greater speed, agility, and efficiency in the face of a rapidly changing operating environment.

The DON has already begun laying the management foundations required to build the Navy the Nation needs. It has invested precious time, taxpayer money, and resources across the three priorities of people, processes, and capabilities. Looking forward to the future, it is critical to continue this momentum by leveraging every resource, expert, leading practice, and efficiency the DON can find – from all sources, private and public – to think anew about business operating models.

As a result of focusing on the three priorities of people, processes, and capabilities, in support of the overarching goal of a more lethal Navy and Marine Corps, the DON has already been able to:

- Increase the size of the fleet,
- Increase the number and quality of its people,
- Increase the number and capabilities of weapons systems,
- Improve the readiness of the force,
- Achieve cost savings through improved business operations, and
- Continue to meet global operational demands.

People

Sailors and Marines are the sea services' greatest advantage and most important asset. The Department remains dedicated to the training and ethical development of Sailors, Marines, and civilian employees to further their competence, confidence, character, and integrity, such that their day-to-day actions and decisions are motivated by and aligned with the Department's core values of Honor, Courage, and Commitment. People are the DON's competitive advantage and there is no higher

priority than to provide the tangible and intangible incentives that will allow the Navy to continue to recruit and retain the nation's elite.

Development of Personnel

Last year, the DON launched Sailor 2025, the Navy's program to improve and modernize personnel management and training systems to more effectively recruit, develop, manage, reward, and retain the force of tomorrow. Sailor 2025 is a set of approximately 45 initiatives built on a framework of three pillars: a modern personnel system, a career learning continuum, and career readiness. The modern, innovative IT infrastructure the Navy is building will help improve the way it recruits, trains, and retains talent; more accurately and efficiently assign talent across the force; better design and account for compensation packages; and generate a system that affords greater flexibility and permeability. Below are examples of programs that have been established based on the Sailor 2025 initiatives:

- **Secretary of the Navy Tours with Industry (SNTWI)** – A service member is offered the chance to learn from and with leading industry partners to improve leadership, management, and communication skills. These tours provide valuable perspective to the civilian business world about the Navy and in turn provide the service member with a unique look at civilian best practices.
- **Meritorious Advancement Program (MAP)** – This program authorizes commanding officers (COs) to advance eligible personnel to the next higher paygrade. The program is intended to give COs the opportunity to recognize their best Sailors by advancing them when they are ready for the next level of responsibility. It gives greater authority to the commands to better shape their workforce and the Navy by developing and rewarding the most talented Sailors. In FY 2018, MAP quotas increased by 66% from FY 2017 and will account for approximately 15% of all E-4 through E-5 advancements in FY 2018.
- **Career Intermission Program (CIP)** – This program was established to address the life/ work challenges Sailors might face. CIP allows active duty or full-time support Officers and enlisted Sailors to take a “sabbatical” from their military services. CIP allows Sailors to transition into the Individual Ready Reserve (IRR) for up to

three years to address these life challenges or opportunities and return to service as stronger Sailors. It may be used for a multitude of personal and professional reasons, from pursuing additional education to starting a family or caring for an ailing loved one. Since 2009, 174 Sailors have been selected to participate in CIP. Of those selected, 91% of participants stayed in the Navy beyond their CIP obligation.

Better talent management extends not just to service members, but also to America's critical civilian workforce in the shipbuilding base. To improve ship maintenance throughput, the Navy initiated efforts to hire and train new public shipyard workers, building the total workforce from 34,918 in FY 2017 to 35,576 as of July 2018, with the goal of reaching 36,100 by FY 2020. The local partnerships in shipbuilding cities across the country are making a tremendous difference in recruiting, grooming, and retaining talented civilian workers to build the Navy the Nation needs.



A midshipman awaits the signal to rappel from a tower during a helicopter rope suspension technique training course. (U.S. Navy photo by Mass Communication Specialist 1st Class Jeff Atherton/Released)

Modernizing Human Resource Service Delivery

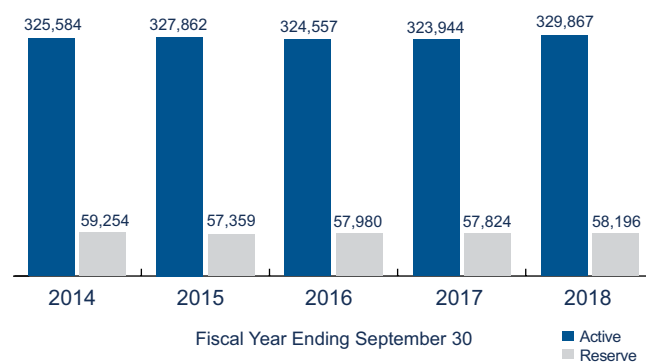
Sailors and Marines have long labored to answer pay, leave, benefits, and other essential life questions for themselves and their families through an arduous, paper-intensive process. The Department is launching new human resources operations centers, such as the Navy's MyNavy Career Center (MNCC). These centers will enable 24/7 self-service options, call center availability, shared service capabilities, and transactional support - bringing Navy HR Operations into the 21st century and meeting the complex and unique needs of Sailors and their families. It also reduces operating costs and simultaneously improves all HR functional areas. The design process leverages proven and fielded industry-wide technology to create a robust and modern service delivery platform that improves quality of service, accountability and transparency. The first MNCC contact center opened in September 2018.

The Navy is also transforming its Manpower, Personnel, Training, & Education (MPT&E) Enterprise to drive efficiency and improve customer service. This restructured business model implements an industry-standard tiered customer service delivery capability through the MyNavy Portal (Self Service Portal with Mobile Access) and Customer Service Support, which helps with complex transactions to include travel, transfers and moves, and status changes between Active and Reserve duty. These changes will require the modernization of Navy HR systems by establishing an Authoritative Data Environment and developing a Navy Pay and Personnel system that streamlines operations, optimizes data management process, drives efficiency, and allows Sailors to conduct personnel matters with ease.

U.S. Navy Military Personnel

The Navy continues to resize and reshape its forces to meet its mission requirements more efficiently and effectively. This is especially important in an environment of limited budgetary resources and rising personnel costs. Over the last five years, the change in the Navy's active component remained flat, while the reserves decreased by 1.8%. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modifications of workforce mix, and new manning practices.

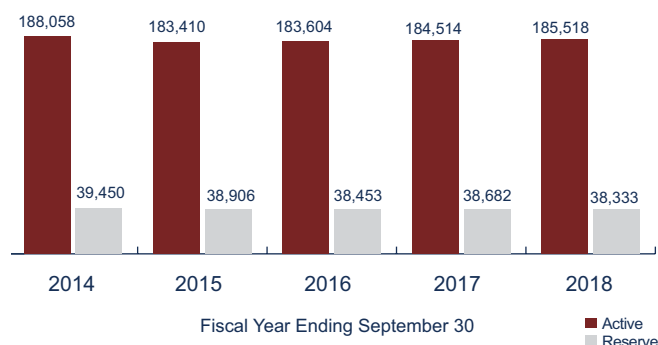
U.S. Navy End Strength



U.S. Marine Corps Military Personnel

The Marines Corps continues to provide a balanced force adequately postured for future National Security Strategy requirements. The Marine Corps ready and capable force structure will provide a strategically mobile, middleweight force optimized for rapid crisis response and forward-presence. Over the last five years, the Marine Corps has decreased its active and reserve components by 1.4% and 2.9%, respectively.

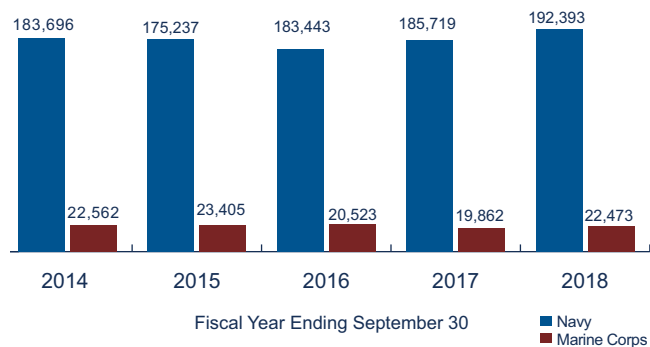
U.S. Marine Corps End Strength



Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 1% for the Navy and decreased by 15% for the Marine Corps over the last five fiscal years, continues to support the mission and daily functions of the Navy and Marine Corps. Civilian personnel provide research and development, engineering, acquisition, depot maintenance, and financial management support.

Civilian Personnel (Full-Time Equivalents)



Processes

The DON is working to improve enterprise processes to enable people to meet complex future challenges. Improved processes begin with improved data, informed by end-to-end protocols that provide the same information to every stakeholder in the institution. The DON will leverage partnerships with industry to incorporate leading practices in how it equips, trains, and fights.

For the first time in FY 2018, the Department of the Navy underwent a full financial statement audit which included reviews of its processes, systems, and resources. Audits are about identifying opportunities for Sailors and Marines to better track the count, location, and condition of inventory and property assets. Better information on military equipment, real property, and spares and parts allows for better analysis and forecasting of readiness capabilities and planning large capital investments. Audits are also about the repeatable, dependable capability to place a receipt in the hands of American taxpayers for every hard-earned dollar sent to the Armed Forces, proving they will get what they paid for – a Navy and Marine Corps ready for the complexity and challenges of a new age. Below are two scenarios in which the audit is already having a positive effect:

- Based on an audit finding and recommendation, the Navy began reviewing and validating its funding obligations on a routine basis. As a result, Commander Pacific Fleet tightened the controls on its obligation management which expanded the Navy's purchasing power to fund ship repair costs, totaling \$4.4 million for the USS Paul Hamilton (DDG- 60). Audits serve to find hidden efficiencies that result in savings of precious taxpayer dollars that can then be reinvested into increased readiness for the Fleet and Marine

Operating Forces, as well as fund needed modernization of platforms, weapons, technology, and equipment.

- As auditors performed a site visit to test government-furnished property related to the F/ A-18 E/F Super Hornet, they found a facility that was not included in the listing provided to them. Personnel at the facility presented an up- to-date list of inventory currently housed in that facility. The auditors performed their testing procedures, including inspection and validation of property stored in the facility. Audits like these reveal inefficiencies and hidden seams that are often buried in legacy paper-based accounting processes. As the Department digitizes its data assets to enable and advanced analytics, Naval personnel and decision-makers will be able to count on the same verifiable accounting data for all their platforms and equipment.

The Navy is also working on ways to improve the acquisition process. The current process is slow and cumbersome with exhaustive management reviews that preclude timely development, acquisition, and delivery of platforms and weapons systems to the warfighters. The ASN (Research, Development, and Acquisition) (RDA) is working to establish policies, programs, and procedures to improve and expedite the acquisition process and enable prototyping enhancements to deliver future capabilities. By utilizing new acquisition tools and decision-making processes, the DON recorded \$4.65 billion of savings in FY 2017 and 2018 on ships and aircraft purchased through multiyear procurements.

Strengthening the Department's business operations is about reforming how the DON does business to better serve the Sailors and Marines who need spare parts, ammunition, fuel, and supplies at the right time and place to get the job done. The Department's business functions are inextricably linked to warfighting capability and readiness, and each of its related support processes has a critical downrange effect on the warfighter. Innovative business reforms will deliver greater organizational agility and free up resources to reinvest in greater lethality. The Navy's Digital Warfare Office (DWO) uses data analytics to tackle numerous challenges facing the Navy. For example, DWO and the Center for Naval Analysis examined the issue of Super Hornet (F/A- 18E/F strike

fighter) readiness and recommended data-driven solutions that leveraged underutilized sensor data. A five-month pilot program began in July 2017, at the Fleet Readiness Center at Oceana in Virginia Beach, Virginia, and was implemented on APG-65 and APG-73 radars. During the pilot program, repair time was reduced by 45% with a 40% reduction in the number of parts being ordered per repair, as well as a 30% reduction in the number of order iterations per repair.

The DON has also reviewed duplicative and non-essential programs for discontinuation. This has resulted in the divestiture of legacy F-18 Hornets in favor of F/A-18E/F aircraft that require lower operating costs; transitioning the HH-60H reserve squadron from legacy aircraft to newer MH-60S aircraft which has a lower cost per flying hour; and a review of Marine Corps training munitions which resulted in new, less-expensive training munitions and elimination of duplicative munition requirement.

To build a more lethal force and reform the DON for greater performance and affordability, the DON must continuously assess and adapt its organizational structure to provide improved support to the warfighter. Management structures and processes are a means to an end - to empower the warfighter with knowledge, equipment, and support systems to be ready to fight and win. Organizational structures that have a limiting impact on lethality or performance must be consolidated, eliminated, or restructured. This may include efforts to optimize organizational structures or remove counterproductive layers of oversight and administration.

One example of optimizing the organizational structure was the reestablishment of Commander U.S. SECOND Fleet during FY 2018. One of the recommendations of the Secretary of the Navy's Strategic Readiness Review was to "reestablish" Commander U.S. SECOND Fleet as the operational and training fleet commander under U.S. Fleet Forces Command. This realignment will reduce overlap between administrative and operational responsibilities and will better enable the Navy's responsiveness to the changing security environment. U.S. SECOND Fleet was officially established on August 24, 2018 to address dynamic geostrategic changes and the rise of peer competition in naval warfare, particularly in the north Atlantic.

Capabilities

The naval services are, in the end, about the national capability to project power and continually achieve

maritime dominance. The DON will align National Defense Strategy-informed plans with the right leaders, tools, budget, and technology advancements, while communicating effectively with Allies and Partners. The Department's relationship with the American innovation ecosystem will evolve in more constructive and mutually beneficial ways, enhancing existing relationships with industry while building new ones for the future.

Readiness

The armed forces have been involved in the longest continuous stretch of conflict in the Nation's history. The continuous nature of these high tempo operations truncated essential maintenance and training, leading to deficiencies in safety, reliability, and availability of Fleet and Marine assets. Concurrently, these operations also led to the depletion of weapons and ammunition stocks, as well as degradations to their supporting systems. Investment uncertainty resulting from budget control actions further complicated efforts to maintain readiness and stable ordnance inventories and created an even deeper erosion of capability across the force. The DON is making targeted, disciplined increases in personnel, platforms, weapons, ammunition, training, and maintenance to ensure that a larger, more lethal naval force is prepared to conduct combat operations against peer adversaries in high-intensity conflict.

In FY 2018, the Navy had a deployable battle force of 292 ships, which includes 11 aircraft carriers and 32 large amphibious ships. Thirteen battle force ships were delivered: two Nuclear Attack Submarines (SSN), four Littoral Combat Ships (LCS), two Expeditionary Fast Transports (EPF), one Expeditionary Sea Base, one Amphibious Transport Dock (LPD), two Destroyers (DDG), and one Zumwalt Class Destroyer (DDG 1000). Two battle force ships will be retired: one Nuclear Attack Submarine (SSN) and the Afloat Forward Staging Base (Interim).

An emphasis on performance to plan resulted in the on-time completion of all four-scheduled aircraft carrier maintenance availabilities in FY 2018, enabling these ships to execute their full pre-deployment training cycles. Maintenance delays have been reduced by over 50% relative to the 2014 peak and cost overruns have been reduced by approximately 20% from the 2012 peak.

The Navy and Marine Corps have re-established the role of aircraft Program Managers (PM) as "cradle-to-grave" life cycle owners for their respective aircraft. Now with

full responsibility and accountability, the PMs were tasked with developing a three-year “Return to Readiness” plan after years of neglect. Partnerships with industry, like those showcased in the “Rhino Recovery Team” at NAS Lemoore, CA, are creating higher levels of mission capable F/A-18 E/F aircraft through improvements in supply chain, manpower, equipment, facilities, and infrastructure. F/A-18 availability improved in part due to increased aircraft assigned to the Lemoore Fleet Replacement Squadron (VFA-122) and standup of the Lemoore Naval Aviation Maintenance Center of Excellence (NAMCE), as well as a NAVAIR-initiated F/A-18 aircraft depot maintenance pilot based on improved data analytics to accelerate the return of aircraft to service.

The Navy is making an aggressive push to explore and refine new combat tactics, offensive weaponry, and networking technologies needed for modern warfare on the open seas. The Navy has invested a considerable amount on development and enhancement of the Navy’s Weapons Program. Weapons programs commissioned in FY 2018 include:

- **Advanced Medium Range Air-to-Air Missile (AMRAAM)** is the next generation, all weather radar guided missile designed to counter existing air-vehicle threats having advanced electronic attack capabilities. Upgrades to the missile incorporate active radar in conjunction with an inertial reference unit and microcomputer that make the missile less dependent on the aircraft fire control system.
- **Evolved Sea Sparrow Missile (ESSM)** serves as the primary surface-to-air ship self-defense missile system. ESSM is an international cooperative effort to design, develop, test, produce, and provide in-service support to a new and improved version of the SPARROW missile (RIM-7P) with a kinematic performance to defeat current and projected threats that possess low altitude, high velocity, and maneuver characteristics beyond the engagement capabilities of the RIM-7P.
- **Small Diameter Bomb Increment II (SDBII)** provides the warfighter the capability to attack mobile targets in all-weather from stand-off range. SDBII address the requirement to attack mobile targets; multiple kills per pass; multiple ordnance carriage; all weather operations; near-precision

munitions capability; capability against fixed targets; reduced munitions footprint; increased weapons effectiveness; minimized potential collateral damage; reduced susceptibility of munitions to countermeasures; and a migration path to net centric operations capability.

Platforms

The DON continues to deliver platforms that possess greater combat power and longer reach in support of missions across all domains. The use of high-tech 3-D printing is making a difference for Marines in the field. The Marine Corps introduced over 100 3-D printers across the service to print repair parts and tools, saving millions of dollars while having an immediate impact to readiness. For example, the Marine Corps printed a M1A1 tank engine impeller and forward deployed Marines with SPMAGTF-CR-CC printed 81mm mortar wrenches. The Marine Corps is the first service with 3-D printers in combat with conventional forces, demonstrating their capacity even in the most arduous conditions downrange.

The DoD established the Defense Innovation Unit (DIU) to accelerate commercial innovation to the warfighter to meet the changing demands of today’s strategic and technological environments. It is DIU’s mission to lead DoD’s break with past paradigms of military-technical advantage to become fast adopters – as opposed to sole developers – of technology, integrating the advanced commercial capabilities necessary for strategic advantage. In this hyper-competitive environment, the DoD needs to prioritize speed of delivery, rapid and modular upgrades, and quick operational adaptation on the battlefield. Success in this new era of military-technical competition no longer goes to those who seek the most exquisite systems, but rather to those who move quickly and think creatively. DIU has awarded prototype projects to the Navy and Marines during FY 2017 and FY 2018. One such project is the multi Drone Defeat in which the Navy has partnered with Citadel Defense Company to deliver radio frequency (RF) detect and defeat devices for counter-unmanned aerial systems (C-UAS). RF detect is accomplished through electromagnetic (EM) pattern recognition and RF defeat is accomplished with various levels of EM mitigation. Another project involves the U.S. Marine Corps Installations & Logistics Command and Local Motors working together to prototype a digital manufacturing process with the aim of deploying portable microfactories in austere environments. As DIU continues to enable faster adoption of commercial

innovation into existing programs of record, DIU will also provide credible, technical expertise for new DoD concepts of operation.

Information Technology and Cybersecurity

Critical to increased agility in business operations is an entirely new approach towards how the DON acquires, uses, and protects information technology (IT). Due to disparate requirements, priorities, and budgets over the years, the Department has often purchased separate IT systems that do not communicate with one another, at both the network and system level. Leadership in IT requires great foresight in scanning the technological landscape for solutions that will hold long-term relevance. Adaptive management in scaling IT systems, and alignment of their architecture with new end-to-end processes, will result in outcomes that serve Sailors and Marines needs in the fleet and field without intervention and allow them to focus completely on their mission. Consolidated Afloat Networks and Enterprise Services (CANES) consolidates five legacy networks and combines them into one, which enhances operational effectiveness and provides better quality of life for deployed Sailors. This includes a common computing environment, an adaptable IT platform that can rapidly meet changing requirements, and network standardization that is scalable to ship class. The Navy owns the data rights to the network, which is supported by low-risk, proven technology. The network will be deployed to more than 190 ships, submarines and Maritime Operations Centers by 2020.

The Marine Corps is reducing seams between garrison and operations by use of a Tactical Cloudlet Infrastructure. This will enable a Marine to take their office laptop from garrison to the field and even to maintain their e-mail and phone number. Cloudlet hardware deployed with Marines will provide the mission critical services and data provided in garrison by connection to the DoD network backbone and will be sized to fit the unit. As with all deployable equipment, cloudlet hardware is Marine-transportable and always ready to operate in global conditions.

Intelligence

In this new era of great power competition, the Nation faces not only adversaries with similar military and strategic capabilities, but also rogue regimes focused on regional destabilization, as well as empowered fringe groups and non-state actors seeking mass disruption. Adversaries are collecting increasing amounts of



Practicing navigation in the Conning Officer Virtual Environment (COVE) shiphandling simulator. (U.S. Navy photo by Ensign Sam Hardgrove/Released)

information on the U.S. military at a rapid pace through successful cyberattacks, exploitation of social media, and other third-party sources. The safety of Sailors, Marines, and their families, both at sea and ashore, depends on the united efforts to continually fight for an intelligence edge.

The DON is working to deliver timely and relevant intelligence, counter intelligence, and security support to Sailors and Marines to provide a decisive and dominant advantage. The Naval Criminal Investigative Service (NCIS) Mission Integration Center is leading a data integration effort that collates and visualizes combinations of classified and unclassified, open source and government-owned information in a way that enhances NCIS' ability to detect, deter, deny, and degrade criminal and foreign intelligence entity efforts. This effort aids in combining diverse skill sets and substantial resources to choreograph complex criminal investigations or launch proactive counterintelligence or counterterrorism initiatives.

The Identity Dominance System program has proven to be “value added” since its introduction in 2013 – providing a decisive advantage to the visit, board, search, and seizure teams conducting maritime interdiction operations. Proactive measures are currently underway to maintain this biometric identification capability within the fleet, in support of NDS strategic goals. This multi-modal (fingerprint, iris and face) biometric collection system provides a reliable and effective capability to collect, share, match, and store identity information.

Alliances and Partnerships

Allies and partners on far shores, as well as those nearby, greatly enable and enhance America’s economic and security future. Strengthening those alliances and partnerships, therefore, is vital to U.S. national security and its way of life. The interconnected nature of national security interests with the global community of states underscores the importance of the Department of the Navy to be postured to nurture and strengthen strategic relationships, reinforce and deepen traditional alliances and partnerships and deter competitors and adversaries.

The Department is working to support the United Kingdom’s (UK) re-establishment of its carrier fleet in a manner that is highly interoperable with U.S. naval forces. By partnering with the UK to integrate the F-35 aircraft with future HMS Queen Elizabeth II’s deployments, the national security of both nations is extended and strengthened.

In March 2018, the U.S. aircraft carrier USS CARL VINSON (CVN-70) paid a visit to Vietnam in the port of Da Nang. The Carl Vinson carries 6,000 crew members, stretches more than 1,000 feet, and weighs more than 100,000 tons. The four-day port call sent a clear message of American intent for peace through strength. Ship visits, combined maritime exercises, and staff planning drills with partners throughout the South China Sea help to maintain peace, stability, security, cooperation, and development in this strategically significant region.

The Rim of the Pacific Exercise (RIMPAC) is the world’s largest international maritime warfare exercise. The U.S. Navy participated, along with 24 other nations, in RIMPAC 2018 with a theme of “Capable, Adaptive, Partners.” Participating nations and forces exercised a wide range of capabilities and demonstrated the inherent flexibility of maritime forces. These capabilities range from disaster relief and maritime security operations to



A guided-missile destroyer launches an electronic decoy cartridge from a Mark 234 Nulka Decoy Launching System while participating in Rim of the Pacific (RIMPAC) exercise 2018. (U.S. Navy photo by Mass Communication Specialist 2nd Class Devin M. Langer/Released)

sea control and complex warfighting. This unique training opportunity helps participants foster and sustain the cooperative relationships that are critical to ensuring the safety of sea lanes and security on the world’s ocean.





Running from an MH-60 Helicopter after removing its chocks on the flight deck of an amphibious assault ship. (U.S. Navy photo by Petty Officer 3rd Class Cosmo Walrath)

Systems, Controls, and Legal Compliance

The DON Commanders, senior leaders, and managers are obligated to safeguard the integrity of its respective programs and operations. Adherence to Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA) enforces the statutory requirements to comply with internal controls that address financial reporting, financial systems, and non-financial operations. Statutory requirements support the production of timely, reliable, and accessible financial information, which facilitate the development and implementation of effective and efficient internal controls. Quantifiable financial information, in conjunction with sufficient controls, create efficiencies to standardize processes and ultimately preserves the DON's limited resources, which is critical to the Department's commitment to national defense and public stewardship.

Included in this section are internal control elements encompassed in the DON annual Statement of Assurance (SOA), which provides management's FMFIA and FFMIA assessment on the current state of internal control. The DON's overview of internal controls over non-financial operations, financial reporting, and financial systems is described within the enclosed sections.

Management Assurances

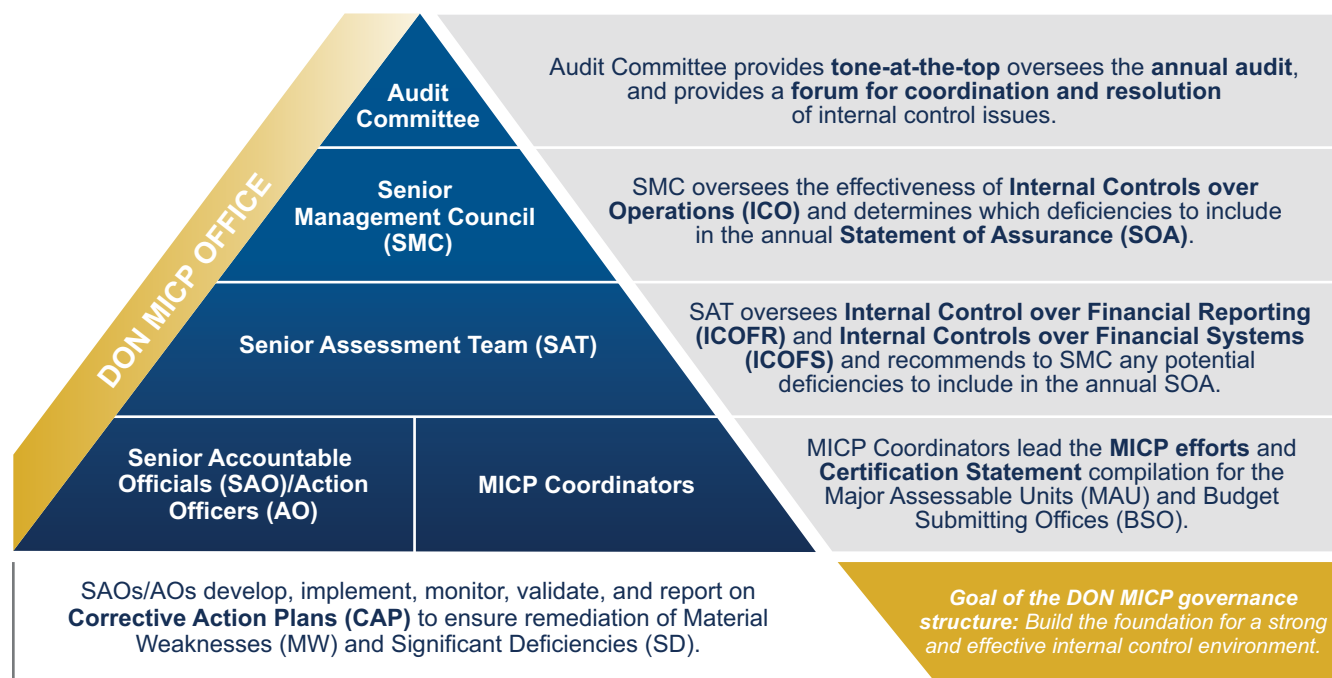
The objectives of the system of internal controls of the DON are to provide reasonable assurance of:

- Effectiveness and efficiency of operations;
- Reliability of financial and non-financial reporting;
- Compliance with applicable laws and regulations; and
- Financial information systems are compliant with the FFMIA of 1996 (Public Law 104-208).

Internal Controls Governance

This year, the DON continued building upon the Managers' Internal Control Program (MICP) governance structure to align with the FMFIA and the Office of Management and Budget (OMB) Circular No. A-123 requirements. The DON implemented a comprehensive internal control governance structure to monitor risks, effectiveness of internal controls, remediation of deficiencies, and report progress in the annual SOA. The governance structure and the roles and responsibilities of each governing body is illustrated in Figure 1.

Figure 1: DON MICP Governance Structure



The DON Audit Committee, chaired by the Under Secretary of the Navy (UNSECNAV), represents the DON's senior-level functional leadership and expertise, provides dedicated oversight of internal control compliance and oversees the annual audit of the financial statements. In FY 2018, the Audit Committee assigned end-to-end process owners to lead the DON's functional business process areas and be responsible for policy development, implementation, and compliance, as well as resolution of deficiencies identified through the MICP or other programs (e.g. independent public accountant (IPA) Notice of Findings and Recommendations (NFR)).

For purposes of assessing DON-wide Internal Controls over Operations (ICO), each Echelon I command is considered a major assessable unit (MAU). A Senior Executive Service (SES) or Flag Officer from each of these MAUs comprise the DON's Senior Management Council (SMC), which is chaired by the Principal Deputy ASN (FM&C) and the Director of the Office of the DON Chief Management Officer. The SMC oversees the DON MICP and advises the SECNAV and the Audit Committee on program implementation, effectiveness, and reporting.

The Senior Assessment Team (SAT) is the governing body that oversees FFMIA compliance activities associated with assessing Internal Control over Financial Reporting (ICOFR) and Internal Controls over Financial Systems

(ICOFS). It is comprised of comptrollers for DON BSOs. The SAT is co-chaired by the Deputy Assistant Secretary of the Navy (Financial Operations) and the Deputy Assistant Secretary of the Navy (Financial Policy and Systems). The SAT provides similar oversight functions to the BSOs as the SMC provides to the MAUs; however, the focus of the SAT is ICOFR and ICOFS.

Both the SMC and SAT meet at least quarterly to discuss Corrective Action Plan (CAP) remediation status, results of risk assessments and internal control testing, and to deliberate as to whether newly identified deficiencies warrant designation as DON-wide material weaknesses (MW) or significant deficiencies (SD). While the SAT can recommend the approval of new or closure of an existing weakness or deficiency, the SMC is responsible for final approval.

Senior Accountable Officials (SAO) are DON SES members or Flag Officers that have been assigned a specific weakness or deficiency, and are responsible for remediating the deficiency and for reporting remediation status to the SMC and SAT. SAOs are assisted by action officers (AO) that implement the CAP(s) to remediate a weakness or deficiency. The MICP Coordinators are the working-level internal control representatives for their organization. They are responsible for ensuring risk assessments are completed, controls are operating

effectively, deficiencies are identified and reported, corrective actions are developed and executed, and internal control assurance certification statements are prepared for their organization.

The DON MICP provides the required framework and guidance for MAUs and BSOs to effectively implement a system of internal controls, complete assessments, and provide accurate and timely reporting. The organizations identify the objectives and the business processes used to achieve their mission. They identify the risk inherent in these business processes and the controls in effect to mitigate them. The MAUs and BSOs perform control assessments to determine conditions that may significantly affect the DON's missions and objectives and communicate their level of assurance via the certification statement. Certification statements are used as the primary source documents for the SECNAV's determination of reasonable assurance over the effectiveness of the DON's operations and processes.

Internal Control over Operations

The DON's MICP is the administrative vehicle for monitoring ICO, ICOFR, and ICOFS. The program mitigates the risk of fraud, waste, and misuse of DON resources, the evaluation and execution of effective and efficient internal control extends to internal stakeholders and external shared service providers.

Responsibility for program execution and reporting resides within a network of 17 MAUs, which includes the Assistant Secretaries of the Navy, the CNO, the CMC, Secretariat Staff Offices, and other entities that report directly to the SECNAV or UNSECNAV.

In FY 2018, the DON identified four new MWs. There were nine uncorrected ICO MWs in the following internal control reporting categories: comptroller and resource management; contract administration; security; manufacturing, maintenance, and repair; personnel and organizational management; force readiness; and information technology.

In addition to ICO assessments described above, the DON MICP encompasses ICOFR and ICOFS into the department's annual SOA to support the Office of the Secretary of Defense (OSD) report to Congress and the President.

Internal Control over Financial Reporting

In FY 2018, the DON continued to build upon prior year progress in improving ICOFR, maintaining focus on its

audit objectives and on a robust internal control program critical to mission success and program sustainability. Internal controls are a cornerstone of the DON's audit remediation program and a key input to its many audit related initiatives.

The DON's BSOs define the assessable units within their organization based on those most critical to the BSO's mission and strategic objectives. The BSOs executed their internal control process, which includes risk assessment, control testing, deficiency identification and subsequent corrective actions, and reporting results in their certification statement. These certification statements and their supporting enclosures, combined with insight from IPA findings that shed further light on the nature and significance of the MWs, are the primary source documents for the SECNAV's determination that controls are not in place to provide reasonable assurance over the effectiveness of the DON's financial operations and processes.

The DON continues to maintain and enhance its standard business processes. Further, the DON worked with its service providers to ensure its business process documentation stays in alignment with the services they provide; documentation is being updated to reflect the alignment of Navy control points to Complementary User Entity Controls. The DON's BSOs participate in monthly change control board meetings designed to obtain concurrence on all recommended process changes. The DON's standard business processes serve as the foundation for BSO internal control testing, and they help to improve the overall control environment.

The DON tested key internal controls within various business processes, using a variety of testing methodologies, and maintained documentation to support its evaluation and level of assurance. In FY 2018, the DON resolved three ICOFR MWs and downgraded one MW, resulting in 20 ICOFR MWs (of which 14 MWs are applicable to WCF) in Fund Balance with Treasury, Financial Reporting Compilation, Contract/Vendor Pay, Reimbursable Work Orders, Transportation of Things, Equipment Assets, Real Property Assets, Inventory, and Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures).

Internal Controls over Financial Systems

The DON made progress during the FY 2018 reporting period towards improving ICOFS. In conjunction with the Office of the Secretary of Defense and service providers, the DON continues to assess relevant financial

system controls to ensure compliance with the OMB Circular No. A-123, Federal Information System Controls Audit Manual (FISCAM), Financial Improvement and Audit Readiness (FIAR), National Institute of Standards and Technology (NIST) Risk Management Framework (RMF), and Financial information systems compliance with the Federal Financial Management Improvement Act of 1996. ICOFS is the foundation of auditability for financial systems. Consequently, the following ICOFS efforts to facilitate an auditable financial systems environment are underway.

The DON maintains several initiatives that impact the DON, specifically concerning providing information technology (IT) control governance in the form of publishing Enterprise IT Control Guidance and maintaining an inventory of IT systems and their financial significance. The DON continued the work of the Financial Information Systems Working Group (FISWG), co-chaired by designees from the ASN (FM&C) and the Office of the DON Chief Information Officer. The FISWG addressed enterprise IT control guidance for NIST Control Families, funding for IT controls/audit requirements, and the RMF transition. The FISWG also empowered DON functional area managers to be the office of primary responsibility for IT notices of findings and recommendations remediation. The DON established an inventory of DON IT systems relevant to its financial statements, including key service provider-owned systems to document the flow of financial data through its IT

systems. The DON continues to refine this inventory by developing clearly defined scoping criteria and closely examining the systems environment.

In FY 2018, a new, comprehensive DON IT systems environment MW was reported. While this pertains to both financial and non-financial systems and is being managed as a ICO MW to ensure governance and visibility across the DON, it significantly impacts the DON ICOFS. This MW, in combination with five previously reported uncorrected ICOFS MWs in IT controls across key and ancillary IT systems, led to the SECNAV's determination that controls are not in place to provide reasonable assurance over the effectiveness of internal controls over financial systems. The five previous uncorrected MWs (non-conformance) include:

- Non-compliance of Navy Enterprise Resource Planning (ERP) system with the Standard Financial Information Structure,
- Deficiencies in Standard Accounting and Reporting System – Field Level (STARS-FL), and Global Combat Support System - Marine Corps,
- DoD Information Assurance Accreditation and Certification Process issues.

ICOFS MWs are assigned to the Office of Financial Policy and Systems and the United States Marine Corps and have a similar remediation and validation process as ICOFR MWs.



A guided-missile destroyer is underway near an expeditionary mobile base platform. (U.S. Navy photo by Mass Communication Specialist 3rd Class Kallysta Castillo/Released)



THE SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

SEP 28 2018

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2018

As Secretary of the Navy, I recognize that the Department of the Navy (DON) is responsible for managing risks and maintaining effective internal controls to meet the objectives of Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The DON conducted its assessment of risk and internal control in accordance with the Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, and the Government Accountability Office (GAO) publication GAO-14-704G, Standards for Internal Control in the Federal Government. Based on the results of the assessment, as of the date of this memorandum, the DON can provide the following assurance levels:

- Internal Controls over Operations (ICO) – Reasonable Assurance, except for nine ICO material weaknesses (MW) identified
- Internal Control over Financial Reporting (ICOFR) – Controls are not in place to provide Reasonable Assurance, due to 20 MWs identified
- Internal Controls over Financial Systems (ICOFS) – Controls are not in place to provide Reasonable Assurance, due to five nonconformances identified

The annex of classified and Special Access Programs (SAP) MWs has been forwarded through special access to the Office of the Secretary of Defense SAP Classified Office.

The "Internal Control Evaluation" section provides specific information on how the DON conducted the assessment of ICO. Based on the results of the assessment, as of the date of this memorandum, the DON can provide reasonable assurance, except for the nine MWs reported in the "Operational Material Weaknesses" section (beginning on page 25), that internal controls over operations and compliance were operating effectively as of 30 September 2018.

The "Internal Control Evaluation" section also provides specific information on how the DON conducted the assessment of ICOFR. Based on the results of the assessment, the DON does not have controls in place to provide reasonable assurance that internal controls over reporting (including external financial reporting) and compliance were operating effectively as of 30 September 2018 in accordance with OMB Circular No. A-123, Appendix A, due to the 20 MWs reported in the "Financial Reporting Material Weaknesses" section (beginning on page 42).

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2018

The DON also conducted a limited internal review of the effectiveness of internal controls over the integrated financial management systems in accordance with the Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. The "Internal Control Evaluation" section provides specific information on how the DON conducted the assessment of ICOFS. Based on the results of this assessment, the DON internal controls over the financial systems do not fully conform to the objective of FFMIA and OMB Circular No. A-123, Appendix D, due to the five nonconformance items reported in the "Financial Management Systems Material Weaknesses/Nonconformances" section (beginning on page 97) as of 30 September 2018.

My point of contact for any questions regarding the Statement of Assurance for fiscal year 2018 is Captain Milton W. Troy, III, who can be reached at (202) 433-9228 or milton.troy@navy.mil.



Richard V. Spencer

Attachments:
As stated

Financial Condition and Results of Operations

The accompanying financial statements and related disclosures represent the enduring commitment to fiscal accountability and transparency. Through the FIAR plan and related business transformation initiatives discussed earlier, the DON has made significant progress toward improving the quality and timeliness of financial information. However, the DON is currently unable to implement all elements of U.S. generally accepted accounting principles and OMB Circular A-136, "Financial Reporting Requirements" due to limitations of financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the DON's Independent Public Auditor was unable to express an opinion on the FY 2018 DON working capital fund financial statements. It should be noted that these limitations exist in both budgetary and proprietary accounting processes. Despite documented material weaknesses and because of compensating measures and close oversight, the DON believes the budgetary information used for decision-making is accurate and reliable.

For financial reporting purposes, the DON WCF is comprised of activity within the Treasury Account Symbol (TAS) 4930.002, *Working Capital Fund, Navy*, within the Department of Defense Department Code 97. Both the U.S. Navy and U.S. Marine Corps execute their working capital fund operations through TAS 4930.002 and are reported on the same set of DON WCF financial statements.

DON Working Capital Fund

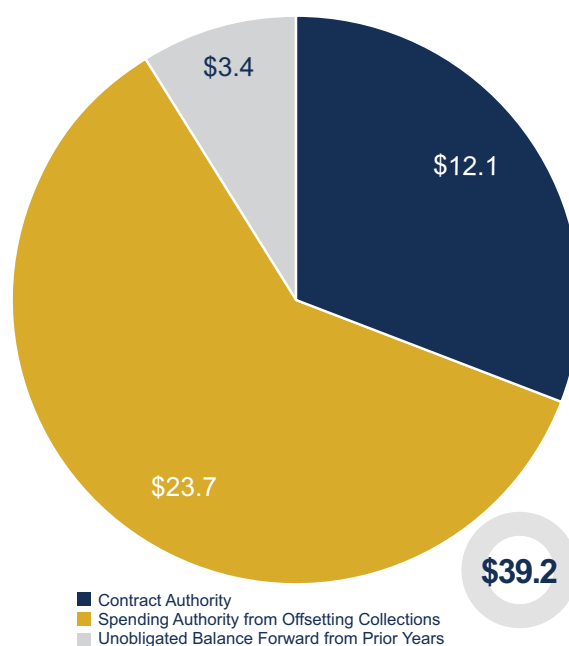
The DON WCF is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial DON WCF operations. General or appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations by Congress. The goal of the DON WCF is to break even over time by matching revenues earned to costs incurred. Achievement of this goal is occasionally complicated by the requirement that DON WCF business areas maintain

stable budget-driven prices for goods and services, to protect customers from unforeseen price fluctuations.

Results of Operations

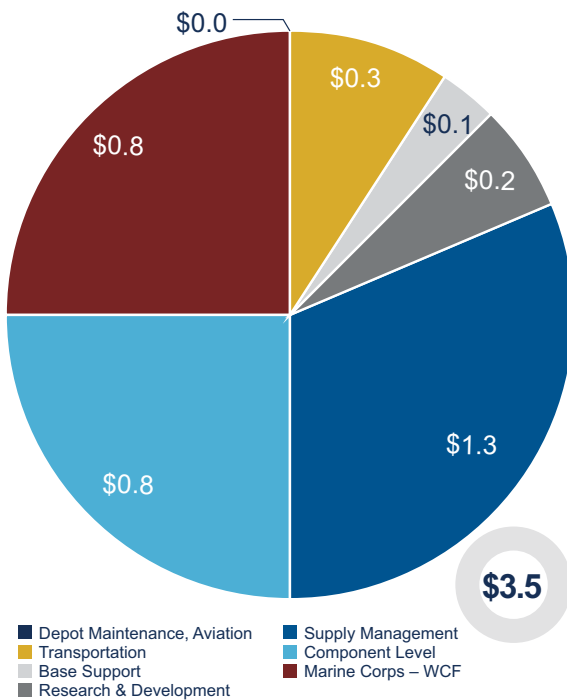
The Combined Statement of Budgetary Resources presents total budgetary resources of \$39.2 billion that were available to the DON WCF during FY 2018 and the status of those resources at fiscal year-end. DON WCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 60.4% of total budgetary resources.

FY 2018 DON WCF Sources of Funds
(\$ in Billions)

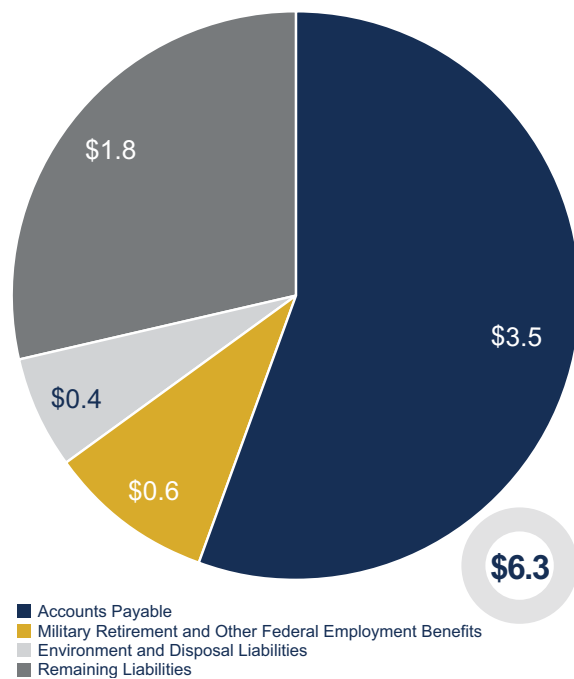


The Combined Statement of Net Cost presents net cost of operations of \$3.5 billion during FY 2018. Net cost of operations represents gross costs incurred by DON WCF less earned revenue. Sources of earned revenue include DON, Army, and Air Force GF; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources. The Statement of Net Cost shows gross costs for the DON WCF and is offset by earned revenues. The following chart shows net program costs by WCF lines of business. "Component costs" represent summarized cost adjustments that are not allocable to a specific WCF line of business.

FY 2018 DON WCF Net Program Costs by Line of Business
(\$ in Billions)



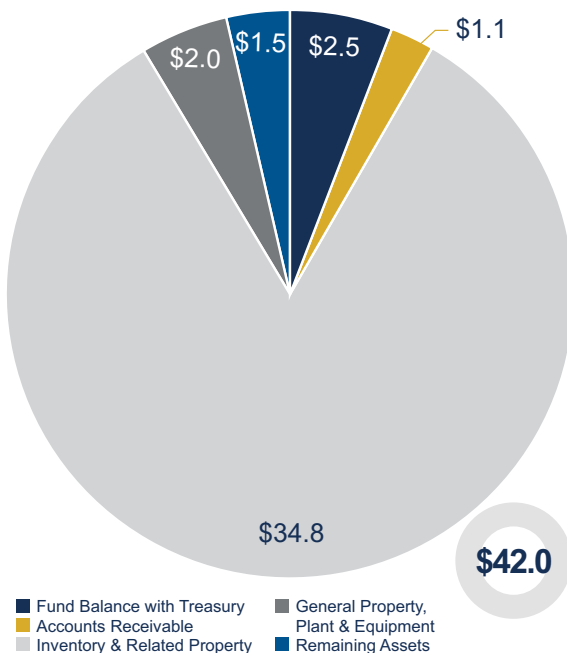
FY 2018 DON WCF Total Liabilities
(\$ in Millions)



Financial Position

The DON WCF reported a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of September 30, 2018, net position totaled \$35.7 billion.

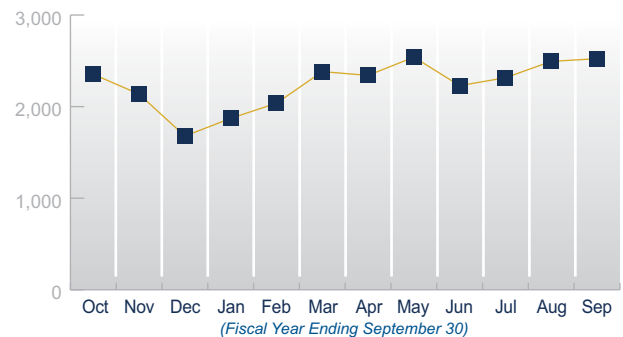
FY 2018 DON WCF Total Assets
(\$ in Billions)



Cash Management

The DON WCF manages working capital fund cash at the Departmental level. It must maintain a minimum cash balance necessary to meet operations, capital investment, and other justified requirements, as required by the DoD Financial Management Regulation (FAR). The DON WCF has established a high and low cash requirement based on business events and activities relevant to its operations. For FY 2018, the high cash requirement was \$2.9 billion and the low cash requirement was \$1.8 billion.

DON WCF Cash Balances
October 1, 2017 to September 30, 2018
(\$ in Millions)





An E2-C Hawkeye flies over a guided-missile cruiser. (U.S. Navy photo by Mass Communication Specialist 2nd Class Alex Millar/Released)

Looking Forward

During FY 2019, The Secretary of the Navy has set forward his three priorities to guide the Department: People, Capabilities, and Processes. These align to Department of Defense strategic business objectives and address known areas of potential risk. Complete alignment with this guidance is the foundation for our Business Operations Plan, and will allow us to create Departmental business processes that directly support the following lines of effort:

Line of Effort 1: Rebuild readiness as we build a more lethal force. We are committed to improving the readiness of the current Fleet by implementing modern business practices, while integrating the most promising emerging technology. We will take full advantage of our greatest asset – the ingenuity of our Sailors, Marines, civilians, and contracting partners – by continually experimenting with new concepts and fostering a culture of innovation. A ready naval force, operating forward, and with the world's best trained and educated warfighters, provides the nation with an unrivaled deterrent capability modeled after the tenet Thomas B. Modly “peace through strength” that has served America so well throughout our history.

Line of Effort 2: Strengthen our alliances and attract new partners. The Navy and Marine Corps maintain robust partnerships with partner states who are committed to maintaining unfettered access to the global commons. The expeditionary nature of our naval mission provides

us with the opportunity to interact and strengthen bonds regularly with our maritime partners and allies. We will continue to uphold and strengthen the maritime institutions that have secured global economic prosperity for the past 70 years, and also attract new partners with a desire to promote global cooperation through positions of naval strength. Further, we will design and implement processes for managing and expanding these relationships that improve cooperation and interoperability.

Line of Effort 3: Reform the Department's business practices for greater performance and affordability. Outdated business practices and systems are a drain on scarce resources and impede our ability to anticipate and adapt. Therefore, improving accountability and management functions are not “nice to haves” — they are operational imperatives. Measuring performance and risk are sound management practices, and must be fully incorporated into the Department's daily decisionmaking cycle. We are entrusted by the American taxpayer to be good stewards of their hard-earned dollars – they rightly rely upon us to eliminate inefficiencies and maximize their investment in naval capabilities for their continued security and prosperity. Our management principles stress:

- Implementing good management practices results in improved operational readiness.

- Executing agile processes ensures we can adapt to changes in our external environment.
- Measuring performance and risk allows us to make better decisions.
- Reducing unnecessary overhead and eliminating non-value added practices frees up resources.
- Always scanning the horizon for new technologies and ways to do our business better will lead to greater agility to meet emerging threats.

Alignment to the National Defense Strategy and the National Defense Business Operations Plan

This Plan aligns to the three lines of effort expressed in the National Defense Strategy (NDS) and to the nine objectives defined in the Fiscal Year (FY) 2018-2022 National Defense Business Operations Plan (NDBOP). These objectives will serve as scales of accountability for the Department in how and where the DON invests every dollar provided by the American taxpayer – a timely, ready receipt for increased efficiency and effectiveness.




National Defense Strategy Lines of Effort	National Defense Business Operations Plan Strategic Objectives
Rebuild Military Readiness as We Build a More Lethal Joint Force	1.1 Restore Military Readiness to Build a More Lethal Force 1.2 Lay the Foundation for Future Readiness through Recapitalization, Innovation, and Modernization 1.3 Enhance IT & Cybersecurity Capabilities 1.4 Ensure the Best Intelligence, Counterintelligence, and Security Support for DoD Operations 1.5 Implement Initiatives to Recruit and Retain the Best Total Force to Bolster Capabilities and Readiness
Strengthen Our Alliances & Attract New Partners	2.1 Reform the Security Cooperation Enterprise
Reform the Department's Business Practices for Greater Performance and Affordability	3.1 Improve and Strengthen Business Operations through a Move to DoD-Enterprise or Shared Services; Reduce Administrative and Regulatory Burden 3.2 Optimize Organizational Structures 3.3 Undergo an Audit, and Improve the Quality of Budgetary and Financial Information that is Most Valuable in Managing the DoD

Read more about the Department of the Navy's Business Operations Plan at: <https://www.navy.mil/strategic/DONBOP.pdf>



LIMITATIONS TO THE FINANCIAL STATEMENTS

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 U.S.C. § 3515(b). The statements are prepared from the books and records of the entity in the formats prescribed by OMB. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

A large background photograph shows a person from behind, looking through a large, complex optical device, likely a ship's searchlight or radar. The person has their hair in a bun and is wearing a dark jacket. The device is metallic and has various lenses and sensors. The background is a bright, hazy sky.

Scanning the horizon for any sign of ships or aircraft aboard a missile destroyer during a training exercise in the Pacific Ocean. (U.S. Navy photo by Petty Officer 2nd Class Amanda A. Hayes)



People

Processes

Capabilities

Sailors conduct a fresh water wash down on the flight deck of a Wasp-class amphibious assault ship. (U.S. Navy photo by Mass Communication Specialist 3rd Class Dominick A. Cremeans/Released)



FY 2018 marks the first year where the entire Department of the Navy (DON) underwent a full financial statement audit. The audit was broken out into three parts: the Navy General Fund, Marine Corps General Fund and DON Working Capital Fund. Completing the audit was a significant milestone for the DON, and we learned a great deal throughout the process. The results of all three audits were disclaimers of opinion. This is the outcome we expected, and we expect to continue to get disclaimers for several more years as we work to remediate the material weaknesses in internal control. It took DHS 10 years to get a clean opinion, and while we don't expect our journey to take that long, it will be a multi-year effort. As we continue with annual audits, we will use the audit process as a tool to improve our financial management systems, processes and controls.

While the audit revealed numerous material weaknesses in internal control over financial reporting, more importantly, it highlighted several areas where the DON needs to improve operationally, in order to improve lethality and readiness. The financial statement audit forced us to look at our supply chain in a new light, and has caused us to challenge much of the thinking that existed over the last several decades. The audit identified business practices that are unacceptable and must change, to improve readiness, lethality and auditability. The auditors met regularly with the DON leadership throughout the audit, communicating their initial findings and highlighting areas where they see opportunities for DON to improve the way we do business. Our leadership is taking action to correct these issues.

- We are removing excess Inventory and OM&S (Operating Materials and Supplies) from our shelves, implementing standard processes for receiving and issuing inventory, improving accuracy of what is in our records, and increasing our ability to get the right part to the right person at the right time, every time.
- We are increasing accountability for real property by conducting a physical inventory of all DON real property in FY 2019. We will identify and fix all discrepancies between what is on our books and what exists in the field, improving our ability to budget, maintain and use our real property.
- We are migrating from legacy business systems that require multiple manual processes into one modern general ledger system, modernizing the ERP system to remove customization and standardize our business processes.
- We are reforming our budget processes by eliminating reimbursable transactions within the same appropriation, implementing zero based budgeting, minimizing the use of reimbursable agreements, instituting a "Perform to Plan" initiative to evaluate outcomes, and moving funds to the place where they will be executed to improve efficiency and execution effectiveness.
- We are working with our financial service provider (DFAS) to improve the financial reporting, Fund Balance with Treasury, and other financial processes by implementing standard controls at the service provider and monitoring controls at DON.

The Department of the Navy's leadership take the audit seriously, and are working to resolve the existing material weaknesses in internal control with a sense of urgency and accountability. As we look toward the budget horizon, the President's signing of the *John S. McCain National Defense Authorization Act/or Fiscal Year 2019* (NDAA) provides the DON both greater clarity and increased opportunity for our funding resources. The 2019 NDAA was signed early in the budget process and empowers the Department by stabilizing our long-term acquisition, forecasting, and budgeting plans. Increased resources come with a heightened need for proper stewardship of the taxpayer's dollar. A key tenet to this is improved performance-based reporting and internal controls at all levels—an effort perfectly aligned to our audit initiatives. I am inspired by our people—both in uniform and in civil service. I've had the privilege of seeing firsthand the dedication and commitment of our Department's personnel in my first year of office, and I am convinced these goals are achievable. I look forward to the work ahead that will clean up our books, improve our business processes, and improve lethality and readiness.

A handwritten signature in black ink, appearing to read 'THW', with a long horizontal flourish extending to the right.

THOMAS W. HARKER
Assistant Secretary of the Navy
(Financial Management and Comptroller)

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 13, 2018

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF
FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
NAVAL INSPECTOR GENERAL

SUBJECT: Transmittal of the Disclaimer of Opinion on the U.S. Department of the Navy
Working Capital Fund Financial Statements and Related Notes for FY 2018
(Project No. D2018-D000FS-0090.000, Report No. DODIG-2019-022)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Department of the Navy (DON) Working Capital Fund FY 2018 Financial Statements and related notes as of September 30, 2018, and for the year ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008. EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amount within the DON Working Capital Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were fairly presented in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the DON Working Capital Fund FY 2018 Financial Statements and related notes.

EY's separate report on "Internal Control over Financial Reporting" discusses nine material weaknesses related to the DON internal controls over financial reporting. Specifically, EY found material weaknesses including: Financial Reporting; Fund Balance with Treasury; Inventory; Property, Plant, and Equipment-Real Property;

Property, Plant, and Equipment–General Equipment Remainder; Oversight and Monitoring; Financial Information Systems (FIS)–Access Controls / Segregation of Duties; FIS-Configuration Management; and FIS-Interface Processing. EY’s additional report on “Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards” discusses two instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed EY’s report and related documentation and discussed the audit results with EY representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the DON Working Capital Fund FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control, conclusions on whether the DON financial systems substantially complied with the “Federal Financial Management Improvement Act of 1996,” or conclusions on whether the DON complied with laws and regulations.

EY is responsible for the attached reports, dated November 13, 2018, and the conclusions expressed in these reports. However, our review disclosed no instances in which EY did not comply, in all material respects, with GAGAS

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.

Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

Attachments:

As stated



Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Working Capital Fund of the United States Department of the Navy (“DON WCF”), which comprise the consolidated balance sheet as of September 30, 2018, and the related consolidated statements of net costs, changes in net position, and the combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the consolidated financial statements (“financial statements”).

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1.B, the DON WCF has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect on the financial statements amounts involved is not currently determinable by DON WCF and could be material.

Basis for Disclaimer of Opinion

The DON WCF continues to have unresolved accounting issues and material weaknesses in internal controls that cause DON WCF to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DON WCF's financial statements as a whole for the year ended September 30, 2018.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis as listed in the Table of Contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board, which considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

The Other Information, as listed in the table of contents, has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 13, 2018, on our consideration of the DON WCF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness on DON WCF's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DON WCF's internal control over financial reporting and compliance.

Ernst & Young LLP

November 13, 2018



Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

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Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund (WCF) of the United States Department of the Navy (“DON WCF”), which comprise the consolidated balance sheet as of September 30, 2018, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated November 13, 2018. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of the work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated financial statements as of and for the fiscal year ended September 30, 2018, and the related notes to the consolidated financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the consolidated financial statements, we considered DON WCF’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DON WCF’s internal control. Accordingly, we do not express an opinion on the effectiveness of DON WCF’s internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-01. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers’ Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we did identify certain deficiencies in internal control that we consider to be material weaknesses.

Material weaknesses

I. Financial Reporting

DON WCF's financial reporting process lacks sufficient and appropriate policies and procedures to identify, detect, and correct inaccurate and incomplete balances in the general ledger, which impact the balances reported on the face of the financial statements, accompanying footnotes, and related disclosures. The combination of these deficiencies results in a material weakness for financial reporting. The matters related to financial reporting are further described in Appendix A.

II. Fund Balance with Treasury (FBwT)

DON WCF is unable to reconcile its FBwT ending balances from the field level general ledger (FLGL) systems and Defense Departmental Reporting System (DDRS) directly to the U.S. Treasury. The lack of policies, procedures, internal controls, and supporting documentation prevents DON WCF from substantiating the completeness, existence, accuracy, rights, and obligations related to FBwT. The combination of these deficiencies results in a material weakness for FBwT. The matters related to FBwT are further described in Appendix A.

III. Inventory

Inventory is comprised of items held by DON WCF for resale, including consumable spare and repair parts and repairable items. Internal controls and procedures are not effectively designed to provide reasonable assurance that inventory, as reported in the financial statements, are free of material misstatements. The lack of policies, procedures, internal controls and supporting documentation prevents DON WCF from substantiating the existence, completeness, valuation, presentation and disclosure of inventory reported on the consolidated balance sheet. The combination of these deficiencies results in a material weakness for inventory. The matters related to inventory are further described in Appendix A.

IV. Property, Plant, and Equipment (PP&E) – Real Property

DON WCF's real property includes land, buildings and structures. The latter of which is segmented into linear and non-linear structures and utilities. The DON WCF has failed to follow their own policies and procedures over real property asset management. The lack of policies, procedures, internal controls, and supporting documentation prevents DON WCF from substantiating the existence, completeness, presentation, and disclosure related to real property. The combination of these deficiencies results in a material weakness for real property. The matters related to real property are further described in Appendix A.

V. Property, Plant, and Equipment (PP&E): General Equipment Remainder (GE-R)

DON WCF's PP&E General Equipment (GE) includes general equipment and assets awaiting disposal. GE-R is primarily comprised of equipment used in research, development and maintenance. The lack of policies, procedures, internal controls and supporting documentation prevents DON WCF from substantiating the existence, completeness, presentation and disclosure related to GE-R. The combination of these deficiencies results in a material weakness for GE-R. The matters related to GE-R are further described in Appendix A.

VI. Oversight and Monitoring

DON WCF does not have an effective OMB Circular A-123 program, which impacts its ability to appropriately identify and address significant risks for key business processes. DON WCF has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DON WCF's environment related to end-to-end business processes, roles and responsibilities, monitoring of service providers, risks and controls. DON WCF's control environment is not appropriately designed to allow for consistent execution of key controls. The combination of these deficiencies results in a material weakness for oversight and monitoring. The matters related to oversight and monitoring are further described in Appendix A.



Financial Information Systems

Our assessment of DON's WCF IT controls and the computing environment identified deficiencies which collectively constitute material weaknesses in the design and operation of information systems controls over financial data. The combination of these deficiencies results in three distinct material weaknesses, which relate to the following three areas:

- Access controls / segregation of duties
- Configuration management
- Interface processing

VII. Financial Information Systems – Access Controls / Segregation of Duties (SoD)

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed. We identified access control and segregation of duties weaknesses that represent a significant risk to the DON financial management information systems environment that include, but are not limited to, the following themes:

- Completeness and accuracy of user populations
- Inconsistent user access provisioning and termination processes
- Inconsistent periodic review or recertification of user access
- Security administrator access to business and functional roles
- SoD monitoring and provisioning of users with SoD conflicts

The combination of these deficiencies results in a material weakness for access controls and segregation of duties. The matters related to access controls and segregation of duties and are further described in Appendix A.

VIII. Financial Information Systems – Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system's life cycle. Weaknesses in such controls

can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed. We identified configuration management weaknesses that represent a significant risk to the DON financial management information systems environment that include, but are not limited to, the following themes:

- Completeness and accuracy of change management populations
- Inconsistent authorization, testing and approval of changes
- Ineffective SoD within critical configuration management processes / access (i.e., developers with migrator access)
- Ability to make direct data changes to production databases
- Inconsistent logging and monitoring of changes

The combination of these deficiencies results in a material weakness for configuration management. The matters related to configuration management are further described in Appendix A.

IX. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems. We identified interface processing weaknesses that represent a significant risk to the DON WCF financial management information systems environment that include, but are not limited to, the following themes:

- Completeness and accuracy of interface populations
- Insecure transmission of interface files
- Inconsistent understanding of financially significant edits and validations
- Lack of file-level reconciliations or the remediation of errors identified during processing



The combination of these deficiencies results in a material weakness for interface processing. The matters related to interface processing are further described in Appendix A.

DON WCF's Response to Findings

DON WCF's response to the findings identified in our engagement to audit, as described above, is included in the accompanying letter dated November 13, 2018. DON WCF's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

November 13, 2018

Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting DON WCF's ability to produce reliable financial statements, accompanying notes, and related disclosures. This process starts with establishing a governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage the identified risks. We identified deficiencies in DON WCF's processes related to the accumulation and presentation of their financial position and results of operations.

DON WCF does not have complete documentation of its end-to-end processes and procedures for the financial reporting process:

- DON WCF is unable to evaluate the risks of material misstatement, design and implement effective internal controls, and demonstrate the operating effectiveness of the controls or mitigate the identified weaknesses prior to the year-end reporting deadlines. For example, the current documentation:
 - Lacks the identification of all key controls, significant risks, and stakeholders.
 - Fails to address the specific procedures as it relates to the DON WCF as opposed to the Navy General Fund (GF).

DON WCF is unable to support, as required by Federal Financial Management Improvement Act of 1996 (FFMIA), transaction-level detail:

- DON WCF determined that the initial scope of the Transaction Universe (TU) was performed in 2016. Therefore, no process currently exists to obtain transaction detail for balances that may have been established prior to Fiscal Year (FY) 16 and reconcile to the financial statements within the DON WCF's TU.

DON WCF failed to research and resolve trial balance variances in a timely manner, which impacted the financial statements:

- Budget Submitting Offices (BSOs) do not have procedures in place for the trial balance reconciliation process, including:
 - Variance investigation thresholds
 - Timely investigation protocols
 - Policies for maintaining supporting documentation

- Specific BSO findings were identified and are noted below:
 - *NAVFAC*: failed to perform a trial balance reconciliation.
 - *NAVSEA*, *NAVAIR*, and *SPAWAR*: do not have documented policies and procedures to perform a trial balance reconciliation.
- DON WCF’s trial balance reconciliation process does not mitigate the risk that incomplete and/or inaccurate trial balance data is submitted to Defense Finance and Accounting Services (DFAS).

DON WCF lacks appropriate controls over the review of journal vouchers (JVs) recorded by DFAS:

- Only JVs with a balance over \$1 billion are required to be sent to DON WCF for review and approval prior to DFAS recording the JV in DDRS.
 - At Q4, there were 292 DDRS-Budgetary (DDRS-B) JVs below the \$1 billion threshold, totaling \$10.3 billion, which were not subject to DON review and approval prior to recording in DDRS.
 - At Q4, there were 39 DDRS-Audited Financial Statement (DDRS-AFS) JVs below the \$1 billion threshold, totaling \$2.1 billion, which were not subject to DON review and approval prior to recording in DDRS.
- DON WCF does not consider qualitative risk factors, such as Treasury Financial Manual (TFM) posting logic noncompliance, one-sided JVs, unsupported JVs, and JVs posted to memo accounts.
- DON WCF does not have assurance that the remaining portion of their JV population would not, in aggregate, have a material impact to the financial statements if recorded in error by DFAS.

DON WCF has known errors in the underlying DDRS trial balance data and “plugs” the correction of the error through the recording of an unsupported JV:

- DON WCF has known substantive JV exceptions in their DDRS-B and DDRS-AFS JV populations.
 - Of the 25 DDRS-AFS JVs tested as of Q2, 18 JVs were identified as testing exceptions. Of the 18 identified exceptions, 3 JVs totaling \$271.9 million were unsupported and identified as “plugs” to the financial statements. An additional 14 JVs, totaling \$4.5 billion, were unsupported.
 - Of the 23 DDRS-B JVs tested as of Q3, 6 JVs were identified as testing exceptions. Of the 6 identified exceptions, 1 JV totaling \$306.0 million was unsupported and identified

as a “plug” to the financial statements. Additionally, 3 JVs, totaling \$1.1 billion, were unsupported.

- One DDRS-B JV tested as of Q4, was identified as a testing exception due to being unsupported totaling \$50.3 billion.

In accordance with Office of the Secretary of Defense (OSD) policy, DON WCF records Trading Partner eliminations that are noncompliant with Generally Accepted Accounting Principles (GAAP) and Federal Financial Management Improvement Act (FFMIA):

- DON WCF records unsupported Trading Partner eliminations that are material to the financial statements. The total amount of Trading Partner eliminations recorded at Q4 was \$8.1 billion.
- DON WCF’s unsupported Trading Partner eliminations impact all of DON WCF’s Financial Statements. This processes indicates that DON WCF does not have appropriate controls in place over its own transactions and is reliant on the records of others.

DON WCF does not sufficiently design, implement, or monitor Complementary User Entity Controls (CUECs) processed by its third-party service provider, Defense Finance and Accounting Service (DFAS).

Recommendations

The recommendations below are in response to the specific issues discussed in the material weakness identified above. DON WCF should also consider a strategic realignment of business processes and consolidation of its system environment to improve financial and operational readiness. EY recommends that DON WCF consider the following corrective actions related to the conditions described above:

- DON WCF document its end-to-end process for the entire life cycle of financial reporting, specific to the DON WCF, including:
 - Initiation, recordation, processing, and reporting controls over financial statement data.
 - Key controls, process owners, data interfaces, and federal regulations followed.
 - A complete list of all input documents, applicable systems and system-generated reports used during the financial reporting process.
- DON WCF and DFAS process owners review and sign off on the updated documentation and policies to validate that they are complete and accurate.
- Design a periodic process to analyze the universe of transaction data at the detail level to assess the impact of unsupported balances on the financial statements.

- Implement a review process for variances identified during the monthly trial balance reconciliation process to include items such as a variance investigation threshold, protocols for timely investigation of variances and retention of documentation.
- Develop a qualitative and quantitative review and approval process for JVs within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and the potential impact on the financial statements.
- Coordinate with OSD to address the Trading Partner eliminations issue at the Department level and develop next steps towards remediation, such as, updating the Department of Defense (DoD) Financial Management Regulation (FMR).
- Implement document level reconciliations with their trading partners and develop a process for resolving differences at the document level.
- Design and implement internal controls that address the CUECs identified in the DFAS's System and Organization Controls reports.
- Consider implementing similar corrective actions for all System and Organization Controls reports that impact DON WCF financial statement data.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in DON WCF's account with the U.S. Treasury (Treasury). We identified deficiencies in DON WCF's processes related to the recording and reconciling of transactions involving FBwT.

DON WCF does not have complete documentation of its end-to-end processes and procedures for the FBwT process:

- DON WCF is unable to evaluate the risks of material misstatement, design and implement effective control objectives, and demonstrate the operating effectiveness of the key controls or mitigate the identified weaknesses prior to the year-end reporting deadlines. For example, the current draft policy documentation:
 - Fails to identify key controls, significant risks, and stakeholders.
 - Does not address the specific procedures as it relates to the DON WCF as opposed to the Navy GF.

DON WCF does not have transaction-level detail to support the recording of its Activity Control Ledger (ACL) JVs:

- Differences are noted as "supported" only through the identification of whether the collection/disbursement transaction was recorded or not recorded by the U.S. Treasury.

Supported differences should be variances that have been investigated and have the requisite supporting documentation to ensure the difference is corrected appropriately.

- The cash reconciliation process at the BSO level is not designed appropriately to execute a cash reconciliation at the transaction level.
- DON WCF lacks standard policies and procedures over the cash reconciliation process.

As of September 30, 2018, there is \$1.15 billion of aged unreconciled transactions impacting the financial statements that are not due to timing differences:

- DON WCF does not consider the impact of aged unreconciled FBwT transactions to the financial statement prior to the period end close process.
- DON WCF has not quantified the impact of these transactions to other USSGL accounts and therefore could be misstating certain line items on their financial statements.
- DON WCF lacks standard policies and procedures over the Cash Reconciliation Report (CRR) process to ensure it is designed to research and resolve unreconciled item in a timely manner.
- Unresolved aged reconciling items, those items that are not due to timing differences, continue to impact the field level trial balances that are submitted to DDRS for period end close process.

DON WCF is recording intra-appropriation activity resulting in an overstatement of collection and disbursement activity on the Statement of Budgetary Resources and SF-133.

- Of the 113 collection samples tested, 16 samples were intra-Treasury Account Fund Symbol (TAFS) transactions.
- DON WCF does not have business processes in place to identify and eliminate transactions of this type as required for proprietary and budgetary reporting.

DON WCF is collecting cash prior to an established funding agreement or in excess of the authorized funding.

- DON WCF inappropriately records collection transactions before funding documents are approved by both parties. This creates a liability to the DON WCF that is currently not being quantified, analyzed, or recognized on the financial statements.

DON WCF's Reimbursements and Other Income Earned – Collected balance on the Statement of Budgetary Resources is misstated in FY18.

- DON WCF cannot evidence that the funds collected reconcile back to the performance of work, provision of goods, or in the period in which the services or goods were provided.

DON WCF cannot identify transactions in Treasury suspense accounts specific to the DON WCF, as of September 30, 2018.

- DON WCF's financial statements and related footnote disclosures may be materially misstated.

Recommendations

The recommendations below are in response to the specific issues discussed in the material weakness identified above. DON WCF should also consider a strategic realignment of business processes and consolidation of its system environment to improve financial and operational readiness. EY recommends that DON WCF consider the following corrective actions related to the conditions described above:

- Document the end-to-end process for the entire life cycle of FBwT, including:
 - Initiation, recordation, processing and reporting of cash transactions, reconciliations, and reporting to third parties.
 - Key controls, process owners, data interfaces, and federal regulations followed.
 - Complete list of all input documents, applicable systems and system-generated reports used during the FBwT process.
- Ensure all process owners, including DFAS, review and sign-off on the updated documentation and policies to validate that they are complete and accurate.
- Establish standard operating procedures for performing the cash reconciliation.
- Ensure that the reconciling items identified, which constitute the need for the recording of the ACL JV, are supportable at the transaction level with key supporting documentation.
- Investigate and correct unresolved over-aged reconciling items in a timely manner.
- Quantify the impact on the financial statements for unresolved aged reconciling items.
- Correct the business process to eliminate the recording of intra-appropriation activity.
- Update policies and procedures to prevent the recording of collection transactions before or in excess of their funding authorization.
- Implement control procedures to reconcile collections that occur outside the period of performance, or subsequent to the funding expiration date, back to the business event that generated the collection to ensure that the business event occurred during the period of performance established in the agreement.

- Evaluate whether an accrual should be recorded for performance of work or provision of goods that occurred, but that DON WCF has not yet collected.
- Identify the necessary data attributes to identify transactions recorded in suspense specific to DON WCF.
- Reconcile the suspense account data and remediate reconciling items that impact the accuracy of the balances.
- Develop an estimate using relevant, sufficient, and reliable information to record DON WCF's suspense account balances on DON WCF's financial statements.

III. Inventory

DON WCF's inventory is comprised of consumable spare parts, repair parts and repairable items. As of September 30, 2018, the DON WCF's inventory is positioned across 900 locations within and outside of the United States and is comprised of approximately 500,000 unique items - identified through National Item Identification Numbers (NIINs). Inventory is held in DON WCF managed warehouses (including ships) and third-party managed warehouses operated by the Defense Logistics Agency (DLA) and contractors. The DON WCF reports the status of inventory using the DON WCF Enterprise Resource Planning (ERP), which is the DON WCF's System of Record for Inventory.

Due to the significance of inventory, both operationally and financially to the Navy, a robust control environment is essential. However, as discussed below, the current control environment lacks the minimum level of controls needed to support the financial statement audit or provide DON WCF with a level of information and data to effectively manage the inventory process. We found the DON WCF's controls and processes to be deficient in both their design and operational effectiveness. Specifically:

DON WCF lacks policies and procedures that accurately document the end-to-end process to account for and report inventory and inventory-related transactions:

- Inventory process documentation, policy memorandum and or standard operating procedures fail to document the processing of transactions and related internal control activities. Specifically, the DON WCF failed to document the processes related to the significant business activities for the movement, warehousing, and disposition of inventory.

DON WCF failed to design or implement effective controls related to inventory held at DON WCF and contractor sites:

- DON WCF failed to design, implement, and document policies and procedures at both DON WCF-managed and contractor-managed warehouses for the physical count of inventories. Industry standard controls require all inventory is counted at least annually,

either in a full physical count or through cycle counts to validate perpetual inventory accuracy.

- Current policy only requires Depot Level Repairable (DLR) and controlled materials to be counted annually and has not stated a position or policy with the remainder of the inventory. Additionally, no risk assessment or evaluation process has been completed to determine an appropriate physical inventory process or to support the current policy.

DON WCF is unable to substantiate the existence and completeness of its inventory due to the following:

- There is a lack of controls, policies and procedures to ensure that inventory receipts and issues are recorded in an accurate and timely manner in the inventory feeder systems and DON WCF ERP. This deficiency was evidenced by various quantity variances observed.
 - Carcasses are repairable items in an unserviceable condition that are returned to a warehouse for repair, modification, or overhaul. The warehouse provides a replacement item prior to the receipt of the carcass; however, the warehouse does not update the records to reflect the inventory issue or receive documentation to substantiate the upcoming receipt of the carcass. This results in a lack of visibility and accountability of items due from the ship or squadron to the warehouse, causing the inappropriate recording of carcass items. Carcasses are incorrectly recorded as inventory prior to receipt without evidence of shipment. Items were recorded as inventory on hand for up to three years without evidence of shipment or receipt.
- DON WCF is unable to perform causative research in a timely manner to resolve variances observed above and was unable to record required inventory adjustments to correctly state its inventory balances at year-end.

DON WCF failed to implement controls related to inventory classification, valuation, or presentations due to the following:

- DON WCF failed to implement controls consistently to ensure that the condition codes assigned to inventory items in the warehouses agrees to the condition codes recorded in ERP. The accounting policy states that inventory balances are based on the following categories: inventory purchased and available for resale, inventory held for repair and excess, obsolete, or unserviceable. Incorrect conditions codes not only result in the misstatements of their value on the financial statements, but provide misinformation as to the availability of items for issue.

DLA holds inventory totaling \$13.4 billion representing 38% of the WCF inventory as of September 31, 2018. The relationship between DLA and the DON WCF is detailed in a Memorandum of Understanding (MOU). DLA reports to the DON WCF the quantity held on their behalf. DON WCF lacks appropriate policies, procedures, and controls to validate that the inventory amounts being reported by DLA are reflected in DON WCF's accountable and financial records. Specifically, DON WCF failed to design controls that reconcile the inventory transactions

reported by DLA to the DON WCF's records. As a result, the DON WCF's inventory records are not complete, accurate or reliable based on the following:

- The interface between DLA's system of record, Distribution Standard System (DSS) and DON WCF ERP, result in differences that are not investigated for root causes to support adjustments that are made. Variances between DSS and ERP accounts for a significant portion of all unreconciled balances (averaging \$2 billion at any given point in time). In order to reconcile the two systems, DON WCF records an unsupported journal voucher in DON WCF ERP to match DSS.
 - This JV impacts the inventory balance in addition to gains and losses amounts on the Statement of Net Cost. The JV recorded as of September 30, 2018, amounted to \$50 billion.
- Furthermore, DON WCF lacks processes and procedures to ensure that inventory quantities on hand are reconciled between DON WCF and DLA. As of September 30, 2018, DON WCF failed to reconcile the count of items held in inventory to the quantity recorded in DON WCF ERP, which totaled \$13.4 billion.

DON WCF has failed to perform appropriate oversight over its contractor-managed warehouses:

- Although DON WCF implemented an inventory count program over its contractor sites during the year, the program was not sufficiently robust or precise enough for DON WCF to substantiate the existence and completeness of inventory held at these sites. DON WCF failed to design and implement adequate oversight or physical inventory count procedures over its contractor-managed warehouses. Our inventory counts procedures were conducted at 41 contractor warehouses, and 377 NIINs comprised of 15,929 items were counted. Discrepancies were observed at 37 locations relating to 162 NIINs comprised of 2,081 items due to poor inventory practices. For instance:
 - At a contractor site that managed only two NIINs, discrepancies were observed in both NIINs due to untimely recording of inventory receipts and issues. In addition, the site was unable to account for a portion of the items even after identifying the unrecorded transactions.
 - Duplicate system entries for inventory items were observed at a contractor site.
 - One contractor stated that a physical inventory count had never been conducted at the site.

DON WCF lacks policies and procedures in place for the appropriate valuation under GAAP for use in the rate-setting process:

- DON WCF does not properly value inventory in accordance with Federal Accounting Standards Advisory Board (FASAB), Statement of Federal Financial Accounting

Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies* and *Stockpile Materials* and SFFAS 3, *Accounting for Inventory and Related Property*.

- DON WCF accounting policy states that it values inventory in accordance to SFFAS 3, “*Accounting for Inventory and Related Property*.” However, the DON WCF’s current business process and financial systems are unable to support valid an accurate valuation of inventory.
- In addition, DON WCF has not implemented an alternative valuation methodology as allowed by SFFAS 48, in order to substantiate and establish inventory beginning balances.

Recommendations

EY recommends that DON WCF considers the following corrective actions related to the conditions identified above:

- Document its end-to-end process for the entire life cycle of the Inventory process, including:
 - Receiving, distributing, recording, processing and reporting of inventory.
 - Key controls, process owners, data interfaces and federal regulations followed.
 - A complete list of all input documents, applicable systems and system-generated reports used during the Inventory process.
- Process owners review and sign off on the updated documentation and policies to validate that they are complete and accurate.
- Design and implement inventory count controls related to DON WCF and contractor managed warehouses for which the following objectives are met:
 - Add a requirement to the inventory processes designed for DON WCF warehouses whereby all quantities in the inventory system are supported via physical counts at least once a year either through a wall-to-wall year-end count or adequately designed cycle counts. Additionally, design and implement a management review control to monitor compliance with inventory count policies and procedures.

- Develop inventory count processes for contractor managed warehouses that include a requirement in the agreements between DON WCF and contractors whereby quantities in the inventory system are supported via physical counts at least once a year either through a wall-to-wall year-end count or adequately designed cycle counts.
- Design and implement an overarching inventory count program using a risk-based statistical sampling approach whereby DON WCF executes counts on inventory items selected using statistical sampling throughout the year that allows them to better monitor their contractor and DON WCF operated warehouses.
- Develop and implement comprehensive policies and procedures to substantiate existence and completeness to include the following:
 - Reconcile physical inventory counts to the respective inventory feeder system and DON WCF ERP. Document, record and resolve any variances observed in a timely manner to ensure inventory is correctly stated.
 - Ensure inventory adjustments are recorded in a timely manner in the respective inventory feeder systems and DON WCF ERP and are fully supported.
 - Design and implement controls, policies and procedures to record inventory transactions and events in both the inventory feeder systems and DON WCF ERP in a timely manner.
 - Design policies and procedures to ensure documentation supporting the various inventory transactions are reconciled, matched for accuracy and maintained.
 - Design and implement a management review control over DON WCF and contractor managed warehouses to monitor compliance with DON WCF's internal inventory policies and procedures such as the NAVSUP Publication 723 on DON WCF Inventory Integrity Procedures.
 - Design policies, process and controls to appropriately account for carcass items.
- Design policies and procedures to ensure inventory balances are classified and presented appropriately in the financial statements:
 - Design and implement policies and procedures to ensure that the accurate conditions codes are assigned to the appropriate classes of inventory recorded in DON WCF's ERP general ledger system and recorded on the inventory at the warehouses.

- Design policies and procedures, to validate the completeness and accuracy of inventory transactions recorded by DLA to include the following:
 - Evaluate the current MOU agreement with DLA to determine whether the agreement sufficiently documents roles, responsibilities, communications, and timelines needed to support reconciliation requirements.
 - Design and implement a reconciliation process between DON WCF's ERP and DLA's DSS financial systems to validate the completeness and accuracy of inventory quantities on hand.
 - Configure the system interface between feeder systems including DLA's DSS and ERP to correctly post all movement types within the period to the appropriate general ledger accounts, including the following:
 - Development of an unreconciled balance report that reflects the entire population of unreconciled balances.
 - Design and implement policies, procedures and controls to research and resolve the unreconciled balances in a timely manner. This should include procedures to determine the balances will be investigated and corrected.
 - Implement management review controls to monitor and approve the status of the unreconciled balances on a periodic basis as well as the maintenance of evidential matter to support the management review process of the unreconciled balances.
 - Design and implement policies and procedures to ensure that the warehouses record inventory movements and events in a timely manner.
- Design and implement a management review program in which DON WCF monitors the operational activities of the various contractor managed warehouses to ensure the following:
 - Implementation of standard practice inventory management policies and procedures. Ensure these policies and procedures are implemented consistently across all contractor-managed warehouses.
 - Warehouses are adequately staffed and managed by personnel possessing the requisite skillset.
 - Compliance with DON WCF's internal inventory policies and procedures such as the NAVSUP Publication 723 on the DON WCF Inventory Integrity Procedures.

- Prior to making an unreserved assertion, DON WCF should:
 - Decide what alternative valuation method it will use for establishing opening balances. Valuation methodologies used should be based on the best available information to arrive at an alternate value.
 - Outline documentation detailing the implementation plan for SFFAS 48 that provides a sufficient description of the process, as well as the proposed application of SFFAS 48.
 - Establish and implement policies and procedures to value inventory that comply with SFFAS 3 on a go-forward basis.
 - Review the implementation methodology to ensure compliance with GAAP.
 - Ensure evidential matter is maintained (e.g., policies and procedures) that documents steps taken to ensure consistent application.
 - Outline the corrective actions to be taken to correct the ERP system-related design deficiencies.

IV. PP&E – Real Property

DON WCF's real property consists of land, buildings, and structures, the latter of which is segmented into linear and non-linear structures and utilities. The Naval Facilities and Engineering Command (NAVFAC) manages and financially reports on real property assets recorded within the system of record known as the internet Navy Facilities Data Store (iNFADS). DON WCF is not able to adequately support the existence, completeness, and valuation of real property assets.

DON WCF failed to prepare complete and accurate process documentation for real property. The existing documentation does not adequately document the end-to-end process of real property transactions and related internal control activities.

- NAVFAC's lack of oversight of the real property enterprise has led to a lack of internal controls and the inconsistent application of existing procedures for additions and disposals, valuation, depreciation, and identification of real property assets.
- The lack of controls over the real property process, results in transaction-level changes in assets not being recorded in a timely manner to support accurate and complete reporting.
- Future programming, budgeting and execution of sustainment requirements will not be based upon accurate asset populations, and budget requests may be insufficient to meet mission requirements.

The DON WCF not only has ineffective policies, they also failed to follow their own real property inventory procedures. Existing policies require asset evaluations be completed every five years for

all real property assets. Testing of opening balances identified real property assets that did not have asset evaluations completed within the required period.

- The real property inventory policy is insufficient due to the lack of internal controls. Conducting an inventory every five years is not frequent enough given the lack of internal controls over the real property life cycle.
- The inventory process and associated internal controls are not designed or operating effectively to identify assets that have been disposed of, and therefore should be removed from iNFADS, or to identify assets that have been added but have not been recorded.
- There is a lack of transaction-level controls as evidenced by the number of additions and deletions identified during opening balance testing that were not recorded within iNFADS.
- DON WCF is not updating the asset records for facilities being occupied by non-DON WCF entities within iNFADS in a timely manner. DON WCF is also improperly reporting assets that have been transferred to other entities. As a result, the DON WCF is reporting assets that it does not own.
- Lack of a complete and accurate baseline inventory prevents reliance upon the recorded real property balances.

DON WCF failed to provide supporting documentation to substantiate all recorded real property transactions or events. Opening balance testing of real property identified that documentation supporting disposals, additions, asset evaluations, property record cards, and/or due diligence worksheets were not available in all cases.

- Unsupported transactions were deemed to be exceptions and unsubstantiated. The impact of these transactions causes a misstatement of the reported real property balances, as well as accumulated depreciation and depreciation expense.

DON WCF failed to consistently implement and/or complete linear segmentation and utilities reconciliations consistently across the enterprise. The reporting of linear segmentation of structures is used to substantiate the existence and valuation of these assets, which are measured by linear feet rather than square feet.

- DON WCF did not complete analyses at all installations.
- DON WCF did not employ a consistent methodology for the recordation of linear assets and utilities across the enterprise. Assets are being recorded as individual or individually segmented assets, while other assets are being recorded at some installations as a group of assets.
- These conditions result in inconsistent reporting of the asset populations and the valuation of linear structures and utilities.

DON WCF failed to affix on-site identification to all real property assets in accordance with its own policy. We noted during beginning balance testing that there were real property assets, buildings, structures and utilities that did not have facility numbers attached, displayed or inscribed on those physical assets. Lack of specific identification of real property assets contributes to management's failure to properly perform real property inventories and to the substantive errors noted below:

- DON WCF did not affix site identification or facility numbers to 1,558 real property assets of the 7,807 items observed during the audit (20%).
- DON WCF did not have Military Grid Reference System (MGRS) location codes or latitude/longitude pairs recorded within iNFADS for 512 of the 1,558 real property assets (32.9%). The MGRS location codes and latitude/longitude pairs provide an alternative means to geographically locate the asset.
- This causes errors within iNFADS, the geographic information system (GIS) the DON WCF uses to assist with the Periodic Virtual Inventories (PVI), and ultimately result in an increased risk to the reliability of the PVI data recorded within iNFADS, which is used for financial reporting and budget formulation.

DON WCF failed to substantiate the existence and completeness of real property assets, such as buildings and structures, recorded in iNFADS.

- DON WCF did not remove 135 real property assets from iNFADS that were identified during opening balance testing and no longer existed. These assets have a recorded Cost-to-Government (CTG) of \$298.0 million.
- Various assets were identified during the opening balance completeness testing. DON WCF was unable to determine whether these assets should have been recorded as GF or WCF. DON WCF needs to perform research to determine which fund the assets should be recorded in and ensure that they are properly recorded within iNFADS.
- The lack of internal controls related to the accuracy of the real property inventory has a direct impact on DON WCF's ability to report its environmental liabilities.

DON WCF failed to reconcile its internal systems, causing real property to be misstated. This is a critical issue, as the cost of assets and their maintenance must be known in order to establish rates for the WCF to charge under Title 10.

- There are five BSOs that have WCF real property, and each is responsible to financially report its respective WCF asset balances. The BSOs are National Research Laboratories (NRL), Space and Naval Warfare Systems Command (SPAWAR), Naval Sea Systems Command (NAVESEA), Naval Air Systems Command (NAVAIR) and NAVFAC. These BSOs are each handling the reconciliations of their respective WCF assets differently.
 - NAVAIR has three divisions that track WCF real property in DON WCF ERP and in the Defense Industrial Financial Management System (DIFMS). NAVAIR does not reconcile its real property inventories from these systems to iNFADS.
 - NAVSEA tracks their WCF real property in DON WCF ERP. NAVSEA was performing monthly reconciliations to iNFADS. However, they are not updating DON WCF ERP for the noted variances.
 - SPAWAR has two divisions and each tracks its WCF real property in DON WCF ERP. SPAWAR is performing quarterly reconciliations to iNFADS; however, it is not updating DON WCF ERP for the noted variances.
 - NRL tracks its WCF real property in Asset Management System (AMS) which is a module of IMPS. NRL performs a reconciliation of its AMS data to iNFADS and correct errors within AMS. However, errors and adjustments identified in the process related to iNFADS and provided to NAVFAC for correction are not processed.
 - NAVFAC tracks its WCF real property in the Defense Working Capital Fund Accounting System (DWAS). NAVFAC is not performing reconciliations to iNFADS and has not for over four years.
 - DON WCF does not have adequate policies and procedures over the reconciliation process.
 - As a result of not adjusting for any historical additions and deletions, the reported balances are inaccurate and incomplete. DON WCF's population of WCF real property assets is incomplete; therefore, valuation of real property cannot be applied as of September 30, 2018.

DON WCF real property assets are not accurately valued as of September 30, 2018.

- DON WCF lacks procedures for the implementation of accounting guidance as it relates to real property. The balances reported for real property are unsupported and they have not implemented SFFAS No. 50 or SFFAS No.6.
- NAVFAC lacks a process to reconcile the CIP data to the real property asset data to ensure that all CIP is properly relieved when buildings are put in service.

Recommendations

The recommendations below are in response to the specific issues discussed in the material weakness identified above. Navy should also consider a strategic realignment of business processes related to real property to improve financial and operational readiness. EY recommends that DON WCF consider the following corrective actions related to the conditions described above:

- Ensure consistent application and compliance with GAAP, DON WCF, and DoD policies and procedures related to real property management, accounting, and reporting.
- Develop comprehensive and complete end-to-end process documentation that speaks to all key financial control points in the various stages of the transaction life cycle of a real property asset, as well as but not limited to: inventory procedures, additions and disposals of real property, valuation, impairment, deferred maintenance, calculation of accumulated depreciation and depreciation expense, and financial reporting controls.
- Revise the existing real property procedures to ensure that life cycle events for real property assets are reflected in iNFADS in a timely manner. Verify the compliance of all policies and procedures related to linear segmentation and utilities. Ensure that reconciliations are performed across all regions and installations, completed timely to support opening balance testing, and that documentary evidence or reports are retained.
- Develop Standard Operating Procedures (SOPs) and desk guides based on intended audience on how to substantiate each type of real property transaction and distribute across the enterprise, and ensure consistent application via appropriate management reviews.
- Research assets found on site during opening balance testing to determine whether they require recordation within iNFADS and the BSO-level APSRs, and determine whether they should be recorded within the GF or WCF inventories based upon their mission functions, supporting acquisition/construction documentation, and/or related funding sources.
- Upon completion of the upcoming physical inventory in FY 2019, ensure that all appropriate adjustments to record additions and disposals within iNFADS and the BSO-level APSRs are recorded in a timely manner.

- Analyze iNFADS and the BSO-level system of record data and make corrections and/or adjustments to fix issues missing values and inconsistencies that affect the completeness and accuracy of the recorded asset information.
- Upon completion of the physical inventory and any and all related updates and adjustments, ensure that valuation procedures are completed and recorded within a timely manner.
- Review, implement, and monitor the procedures related to displaying on-site identification and perform annual site reviews to ensure any new buildings have an identification number affixed to the building.

V. PP&E – General Equipment Remainder

DON WCF's PP&E General Equipment (GE) includes general equipment and assets awaiting disposal. GE-R, valued at \$571.6 million is primarily comprised of equipment used in research, development, and maintenance. GE-R assets are typically used for performing repair and maintenance or for research and development. We found that the DON WCF does not have appropriate controls in place to ensure existence and completeness of its GE-R population and has not been accurately reporting its GE-R balances.

The DON WCF does not have effective policies and procedures in place over GE-R:

- DON WCF has not documented its end-to-end processes for GE-R, which impedes its ability to prevent or detect errors.
- Processes for performing a physical inventory and associated internal controls are not designed or operating effectively. In multiple instances, assets are still being recorded in the system as many as four years after being disposed of. In other cases, DON WCF owned assets for nine years before they were recorded.
- DON WCF issued a policy in direct conflict with DoD policy regarding timeliness of resolution of discrepancies found during performance of physical inventories. DoD instructions require that discrepancies be researched and resolved within seven days of identification. DON WCF policy allows thirty days from identification of discrepancies to resolve. However, as noted above, DON WCF failed to follow its own policy. As a result, the GE-R balance presented is misstated.
- DON WCF has not implemented United States Standard General Ledger (USSGL), *General Property, Plant, and Equipment Permanently Removed but Not Yet Disposed*, although use of the account became effective in FY13. This account should hold all assets that are currently slated to be disposed of at a zero net balance. As a result, it is likely that the GE-R balance reported is misstated. Additionally, DON WCF is making budgeting decisions based on the expectation that certain equipment is available for use, when equipment may actually be obsolete or otherwise unfit for use.

DON WCF is unable to identify a complete population of its general equipment assets.

- DON WCF is unable to provide a population of GE-R that reconciles to their financial records. The DON WCF does not report balances in the appropriate period, and does not investigate and resolve variances prior to preparing their financial reports. As a result, the GE-R balances reported are misstated.
- DON WCF does not keep accurate and current location records in its systems for GE-R. In many instances, the location recorded is not the physical location of the asset, but rather the primary location of the owning activity. This has resulted in the inability to locate items that are recorded in the system and increased the risk that the GE-R balance reported is misstated and assets are missing.

Recommendations

The recommendations below are in response to the specific issues discussed in the material weakness identified above. DON WCF should also consider a strategic realignment of business processes and consolidation of its system environment to improve financial and operational readiness. EY recommends that DON WCF consider the following corrective actions related to the conditions identified above:

- Finalize documentation of the end-to-end process for the entire life cycle of GE-R, including the initiation, recording, processing, and reporting of GE-R transactions, applicable risks, and key controls that address those risks.
- Establish policies and procedures for an effective annual physical inventory of assets, which includes verification of property existence, data accuracy and completeness, and require the updating of specific information about the asset, such as custodian name and physical location.
 - Establish and implement internal controls to ensure policies and procedures are followed for any change in custody, including when a custodian leaves or retires, such that all assets are accounted for and the system is updated.
 - Establish and implement internal controls to ensure system adjustments are completed within a timely manner following instances of assets found or lost in between physical inventory periods.
- Implement policies and procedures to ensure asset transfers, dispositions, and losses are recorded in a timely manner.
- Establish internal controls designed to detect asset transfers, dispositions or losses that have not been recorded in the reporting period in which they took place.
- Implement Department of Defense Instruction 5000.64 Enclosure 4.2 to accurately update the data elements in the system of record.

- Establish and implement internal controls to ensure location discrepancies are investigated upon discovery subsequent to physical inventory.
- Establish and implement internal controls to ensure the location entered in the system is the physical location of the asset, rather than the primary location of the owning activity.
- Develop and implement policies and procedures to reclassify capitalized assets that are no longer in service prior to disposal, retirement or removal to USSGL 199500.
 - Prepare and maintain adequate supporting documentation of management’s decision to dispose, retire, or remove assets from service.
- Implement internal control to ensure that all reportable GE-R assets are included in the PP&E balance and the related footnote.

VI. Oversight and Monitoring

Oversight and monitoring relates to DON WCF’s lack of establishment and implementation of a sufficient control environment, enterprise-wide. DON WCF lacks an effective OMB Circular A-123 program, which impacts its ability to appropriately identify and address significant risks for all key business processes. DON WCF has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DON WCF’s environment related to end-to-end business processes, roles and responsibilities, monitoring of service providers, or contractors.

DON WCF lacks sufficient policies and procedures around oversight of financial recording and reporting, including:

- Lack of sufficient written policies and procedures related to management review controls. We identified specific areas where management oversight of reporting activities was lacking. For example, DON WCF:
 - Failed to develop end-to-end business process documentation in the form of process cycle memorandum; therefore, it did not appropriately identify inherent risks and process controls.
 - Failed to implement a policy for developing Enterprise Risk Management (ERM) and internal control, including the appropriate documentation requirements that are necessary as a part of an effective internal control system.
 - Failed to provide sufficient guidance and instructions to the BSOs in order for internal control testing to be performed consistently and effectively. Therefore, control documentation and results are inconsistent for the BSOs.

DON WCF lacks a sufficient control environment related to internal controls over financial reporting, including a sufficient A-123 program:

- Failed to develop its department-wide risk assessment in a timely manner. Furthermore, DON WCF has not developed and/or finalized the process documentation that would identify risks inherent in unique processes and those key internal controls designed to identify weaknesses, omissions and/or errors within the internal control environment or financial statements.
- We observed a lack of management oversight to monitor and correct, when appropriate and in a timely manner, abnormal balances within their general ledger systems.

DON WCF has not designed and/or documented entity level controls to ensure compliance with GAO Green Book (GAO-14-704G), *Standards for Internal Control in the Federal Government*:

- The entity level control environment is not designed to address all the standards for internal controls in the Federal government as prescribed by the GAO Green Book.

DON WCF's oversight of service providers controls is insufficient:

- DON WCF depends on DFAS to perform key financial reporting controls on their behalf. DFAS procedures are not designed to verify the completeness and accuracy of the data within the reports utilized to as part of their review of key controls. Additionally, DON WCF does not have compensating controls in place.
- Defense Contract Management Agency (DCMA) procedures are not designed to validate existence and completeness of government-owned property, however, DON WCF currently relies on the DCMA for that purpose.

DON WCF's oversight of contractors that have DON WCF property in physical custody is weak or absent. The lack of consistent reporting by contractors that allows for accurate and verifiable financial and logistical knowledge of property held by the contractors can also have an operational impact due to mismanagement of inventories.

Recommendations

The recommendations below are in response to the specific issues discussed in the material weakness identified above. DON WCF should also consider a strategic realignment of business processes and consolidation of its system environment to improve financial and operational readiness. EY recommends that DON WCF consider the following corrective actions related to the conditions described above:

- Continue to design and implement Navy Statement of Assurance (SOA) policy at all levels throughout the organization and emphasize the importance of the Manager's Internal Control Program (MICP) from DON WCF leadership. This is necessary to bring visibility,

education and support to the program from across the organization and at the highest levels of leadership.

- Ensure DON WCF policy includes proper detail and guidance for conducting the risk assessment process, including:
 - A process to review all aspects of the risk management processes at least once a year
 - Review of the previous risks identified with appropriate frequency
 - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed
- Identify, document and communicate roles and responsibilities throughout DON WCF as they relate to the implementation of MICP. Ensure the proper groups and personnel that are involved are trained at the appropriate levels to produce the most effective results.
- Develop, document and maintain supporting documentation as a part of the MICP and for the ERM as evidence that DON WCF developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans and tracked progress towards remediation
- DON WCF should evaluate the current review controls identified to operate over an entire process:
 - Evaluate each control to determine whether multiple controls actually exist in the process.
 - Assess control descriptions to ensure they are documented completely, including how the control is applied, who is responsible, how frequently it is performed, and how the control is evidenced.
- Leadership appropriately document their rationale for principles and/or attributes they do not find relevant to the entity.
- Documentation of entity-level controls; consider whether a control is applicable to more than one principle and document that rationale.
- Create documentation that is maintained to demonstrate a control was executed.
- Design management review controls (MRC) related to actions performed by DFAS that are appropriate and/or develop procedures to mitigate the MRC risks identified. Retention of adequate documentation evidencing the procedures performed during their review should include, but is not limited to:

- Procedures performed/re-performed
- Verification that the data transferred from a system of record to an End User Computing tool, such as Excel, is not lost, added, or changed
- Assess policies and procedures governing oversight of third-party service providers and identify the appropriate level of oversight and monitoring required to ensure accurate and complete reporting.
- Identify the level of oversight required of contractors that have government property in custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and periodic monitoring.
- Implement changes to contracts to allow for contractors with property in custody to accurately report the property in accordance with federal accounting standards. Include in the contracts the actions necessary for government personnel to monitor the reports and data presented for accuracy.

Financial Information Systems

The DON WCF lacks a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Consequently, a prioritized, risk-driven effort, is necessary to remediate deficiencies in the areas of access controls, segregation of duties (SoD), configuration management and interfaces. Our assessment of the Information Technology (IT) controls and the computing environment focused on a subset of DON WCF financially significant applications that included general ledger systems, feeder systems and operational systems. Based on our procedures performed in support of the FY2018 DON WCF Financial Statement Audit, the following table outlines the number of deficiencies identified across all 14 systems in scope for the WCF:

System Type	FY18 DON Financially Significant Systems – IT Internal Controls Deficiencies				
	Security Management	Access Controls / Segregation of Duties	Configuration Management	Interface Processing	Totals
General Ledger Systems	29	111	37	35	212
Feeder and Operational Systems	69	149	75	98	391
Totals	98	260	112	133	603

Based on the results outlined above, we noted the following:

- 84% of all control deficiencies identified across all system types map to high-risk control domains (i.e., access controls, segregation of duties, configuration management and interface processing)
 - 43% of control deficiencies are a result of Access Control (AC) / Segregation of Duties (SoD) deficiencies
 - 19% of control deficiencies are a result of Configuration Management (CM) deficiencies
 - 22% of control deficiencies are a result of interface processing deficiencies

A subset of the deficiencies identified were high-risk, which collectively constitute a material weakness in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. Based on our review and analysis of the findings in aggregate, we have identified three distinct material weaknesses related to information system controls.

We have outlined the three IT material weaknesses below:

- Access controls / segregation of duties
- Configuration management
- Interface processing

VII. Financial Information Systems – Access Controls / Segregation of Duties

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, monitoring, and physical security. When properly implemented, access controls can help ensure that critical systems assets are safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the DON WCF financial management information systems environment include the following:

- Complete and accurate, system-generated populations of users were not consistently available, or evidence to support this was not provided, to include source and level of access granted.

- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege – specifically, between those with privileged security access and those with functional access.
- User access provisioning, to include initial access provisioning, modification and removal were not performed in accordance with defined requirements, timelines and with sufficient detail to confirm access currently granted in the system was commensurate with access approved and required for the users business function.
- User access recertification / periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
- Audit logging information was not protected against unauthorized access and modification, as well as not being retained for the audit period.

An effective control environment guards against a particular user having incompatible functions within a system. Segregation of duties controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

The identified SoD weaknesses that represent a significant risk to the DON WCF financial management information systems environment include the following:

- Cross application segregation of duties analysis has not been performed across key financial systems to determine the significance and pervasiveness of these types of SoD conflicts. Additionally, cross application SoD is not considered when provisioning user access.
- Access rights and responsibilities were not appropriately restricted to independent users and assigned in accordance with SoD policies.
- SoD matrices or equivalent were not consistently documented, inclusive of all functional roles or not mapped effectively to the system access associated with the functional roles.
- Inability to prevent assigning conflicting roles during the access provisioning process, and for known conflicts where SoD concerns were identified, lack of documentation for business rationale and subsequent monitoring of a user's activity.
- Multiple systems had a significant number of administrator users (i.e., database administrators, developers) able to complete an entire functional process by inputting, processing, and approving transactions.

Recommendations:

The DON WCF should implement controls to address the IT material weaknesses relating to access controls / segregation of duties

- Systematically generate population of users, and incorporate completeness and accuracy procedures into review controls to confirm a holistic evaluation of the user base.
- Implement monitoring and review controls for users with elevated access privileges.
- Establish and consistently follow processes and controls related to user account management and segregation of duties, including the entire life cycle from access provisioning to recertification, modification of access, inactivity restrictions, and termination procedures.
- Segregate roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.
- Evaluate cross-application segregation of duties to identify potential conflicts for users accessing multiple systems.
- Conduct appropriate analysis to confirm functional user access is tied to the appropriate logical permissions within the systems and confirm SoD is enforced.

VIII. Financial Information Systems – Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system's life cycle. By implementing configuration management controls, DON WCF can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified configuration management weaknesses that represent a significant risk to the DON WCF financial management information systems environment include the following:

- Complete and accurate, system-generated populations of changes made to the production environments are not captured or available to support the audit. This includes code changes, direct data changes, configurable settings within the application and changes to interfaces.
- Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application, database, interface and data.
- Lack of a segregated environment; developers have access to the production environment.

- Configuration changes are not properly reviewed, approved, and documented.
- Although management relies on third-party providers to perform many aspects of the configuration management functions for the relevant applications, there is no review or monitoring to ensure compliance with the currently approved configuration management process.

Recommendations:

The DON WCF should implement controls to address the IT material weaknesses relating to configuration management:

- Identify complete and accurate populations of configuration changes in order to monitor changes to determine only authorized and approved changes are being applied to production.
- Segregate access between development and production environments.
- Establish controls to monitor third-party support organizations associated with the configuration management of DON WCF applications.
- Establish audit logging capabilities in order to monitor changes to the application, database, interface and data to ensure they are authorized.

IX. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the DON WCF financial management information systems environment include the following:

- A complete population of interfaces, systematically generated or systematically validated could not be provided to support the complete and accurate processing of DON WCF transactions.
- Validation checks are not consistently implemented across interfaces to prevent the processing of duplicate or inaccurate data.
- Reconciliations are not being performed between source and target systems to ensure completeness and accuracy of processing.

- Logs of interface processing activities are not retained to support subsequent auditing and monitoring; error reporting for failed interface processing activities has not been implemented in some systems.
- Interface files are not protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.
- Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.

Recommendations:

The DON WCF should implement controls to address the IT material weaknesses relating to interface processing:

- Conduct an appropriate analysis and implement procedures to confirm that the population of known interfaces is complete and accurate.
- Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.
- Conduct an appropriate analysis to determine financially significant validation and edit checks within the interface process to determine whether the interface files are being subject to appropriate validation and edit checks and that they are operating as designed.
- Implement controls to confirm that the information received or sent from a target to source application is complete, accurate and consistently received.
- Test system interfaces in an end-to-end manner for DON WCF to gain reasonable assurance that system consolidation efforts will retain desired / intended functionality.
- Implement consistent controls to log interface activity and monitor these logs to allow for timely remediation of errors associated with the transmission of data used in financial reporting.
- Management should protect data files transmitted via interfaces from inadvertent or intentional access or modification prior to data processing.



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Report of Independent Auditors on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund of the United States Department of the Navy (“DON WCF”), which comprise the consolidated balance sheet as of September 30, 2018, and the related consolidated statements of net cost, consolidated statement of changes in net position, and combined statement of budgetary resources for the year then ended September 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated November 13, 2018. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of the work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the fiscal year ended September 30, 2018 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-01, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement to audit, and accordingly, we do not express such an opinion. We limited our tests of compliance of these provisions, and we did not test compliance with all laws and regulations applicable to DON WCF.

The results of our tests of compliance with laws and regulations described in the second paragraph of this report disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-01, which are described below. In addition, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.



FFMIA

Under FFMIA, we are required to report whether DON WCF’s financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (“USSGL”) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which DON’s financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in Fiscal Year (“FY”) 2018 Navy Statement of Assurance, the DON WCF self-identified that financial systems and financial portions of mixed systems do not substantially meet FFMIA or OMB Circular A-123, *Management’s Responsibility for Enterprise Risk Management and Internal Control* (“Circular A-123”) Appendix D.

EY confirmed this material weakness as part of the Financial Information Systems material weakness, contained in the *Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* (“Report on Internal Control”), where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with access controls/segregation of duties, configuration management and interface processing. These financial system deficiencies prevent the DON WCF from being compliant with federal financial management system requirements and inhibit DON’s ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2018 Navy Statement of Assurance and Note 1B to the financial statements, DON WCF self-identified that the design of legacy financial systems does not allow DON WCF to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual basis of accounting. EY also identified noncompliance with federal accounting standards during our testing, which was included in our Report on Internal Control.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2018 Navy Statement of Assurance, DON WCF self-identified that the design of legacy financial systems does not allow DON WCF to comply with USSGL at the transaction level. EY also identified noncompliance with USSGL posting logic during our testing, which was included in our Report on Internal Control.



FMFIA

Federal Managers' Financial Integrity Act ("FMFIA") requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

The DON WCF was not able to provide evidence that they are in compliance with significant aspects of Circular A-123, which implemented FMFIA. The DON WCF provided a FY 2018 Statement of Assurance; however, there was not sufficient evidence that each process identified by DON WCF fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY notes that DON WCF has started to implement an A-123 testing strategy; however, DON WCF is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

Navy's Response to Findings

Our Report on Internal Control dated November 13, 2018, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DON WCF's management responsible for addressing the noncompliance are provided in their letter dated November 13, 2018. We did not audit management's comments and accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on DON WCF's compliance. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose. This report is intended solely for the information and use of management, the Department of Defense Office of Inspector General, the OMB, the Government Accountability Office and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

November 13, 2018



THE ASSISTANT SECRETARY OF THE NAVY
 (FINANCIAL MANAGEMENT AND COMPTROLLER)
 1000 NAVY PENTAGON
 WASHINGTON DC 20350-1000

Ernst & Young LLP
 Attention: Mr. John F. Short, Partner
 1775 Tysons Boulevard
 Tysons, VA 22102

Dear Mr. Short:

The Department of the Navy (DON) reviewed the Auditors' Report prepared by Ernst & Young LLP for the audit of the DON Working Capital Fund. We are not surprised that the outcome of the Department's financial statement audit is a disclaimer of opinion, and that we have material weaknesses as this is our first full financial statement audit. The Navy appreciates the recommendations from the auditors and we look forward to working with you to improve financial management in our Department.

Undergoing financial statement audits and improving our systems, processes and controls as a result of the audits is new to the DON, and we embrace the opportunity to do so. We recognize that we get tremendous value from these annual audits, as we use the audits to drive improvements into our programs. The audits will identify opportunities to improve the quality of information on count and condition of mission critical assets that will allow better analysis of our readiness capabilities, and will enable us to save and reinvest hundreds of millions of dollars due to increased efficiency and effectiveness.

In order to focus our effort to remediate these material weaknesses, the Navy established the following remediation priorities and lines of efforts for the DON that have been included in the DON Business Operations Plan. These priorities were established with a sense of urgency to improve how we manage the Department in order to continually reinvest into improved readiness and modernization of our force.

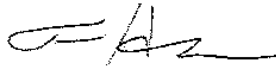
Our remediation efforts are prioritized around the following key initiatives that represent most material and significant drivers of audit findings:

- Accounting Systems – the Department will reduce its accounting systems footprint from nine general ledger systems to two by October 2020, with the ultimate goal of one by 2021. Further, it will modernize our SAP accounting system by de-customizing and reengineering its business processes to remove customization.
- Business Systems Consolidation – the Department will develop an enterprise system architecture to drive system consolidation and reengineering of its key audit relevant business processes and systems.
- Financial Reporting & Fund Balance with Treasury Reconciliation – the Department will reengineer the end to end business processes by eliminating unnecessary steps and systems, and by standardizing the reconciliation and reporting process to comply with GAAP.

- Inventory & Operating Materials and Supplies (OM&S) – the Department will standardize its processes to properly account for its assets and will execute a wall to wall count of inventory and OM&S.
- Real Property – the Department will standardize its processes to properly account for its real property assets and will execute a 100% count of its assets.
- Budgetary Reform – the Department will streamline its funds receipt and allocation process by moving the funds to where they are executed to ensure accountability and visibility of execution, and reduce waste caused by unnecessary reimbursable agreements.
- Information Technology General Controls – the Department will leverage new technology and retire legacy systems to increase oversight and control over access and security of our system environment.

We recognize that remediating these long-standing issues will take a few years, but I am confident that our U.S. Navy and Marine Corps will rise to the occasion and we will get them fixed. Thank you again for your report and we look forward to our continued partnership.

Sincerely,



Thomas W. Harker



DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

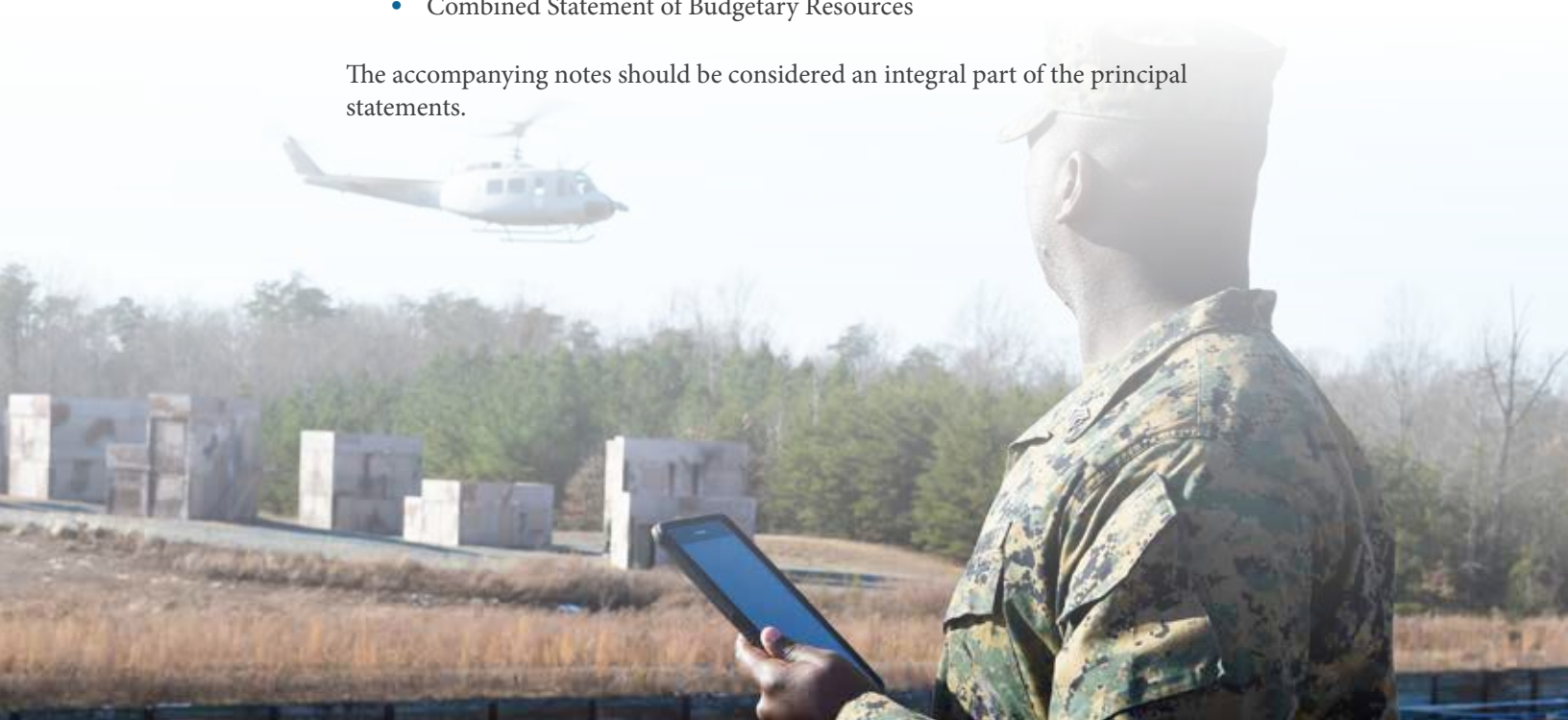
PRINCIPAL STATEMENTS

The fiscal year 2018 DON WCF principal statements and related notes are presented in the format prescribed by OMB Circular A-136. The statements and related notes summarize financial information for individual funds and accounts within the DON WCF for the fiscal year ending September 30, 2018 and are not presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2017.

The following statements comprise the DON WCF principal statements:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources

The accompanying notes should be considered an integral part of the principal statements.



Department of Defense
DEPARTMENT OF THE NAVY WORKING CAPITAL FUND
CONSOLIDATED BALANCE SHEET

As of September 30, 2018
(\$ in Thousands)

	Unaudited 2018 Consolidated
ASSETS	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	\$ 2,523,125
Accounts Receivable (Note 4)	1,079,965
Total Intragovernmental Assets	<u>3,603,090</u>
Accounts Receivable, Net (Note 4)	52,678
Inventory and Related Property, Net (Note 6)	34,777,296
General Property, Plant and Equipment, Net (Note 7)	1,993,383
Other Assets (Note 5)	1,528,484
TOTAL ASSETS	\$ <u>41,954,931</u>
LIABILITIES	
Intragovernmental:	
Accounts Payable (Note 9)	\$ 258,001
Other Liabilities (Note 11)	296,920
Total Intragovernmental Liabilities	<u>554,921</u>
Accounts Payable (Note 9)	3,260,475
Federal Employee and Veteran Benefits (Note 13)	627,406
Environmental and Disposal Liabilities (Note 10)	372,883
Other Liabilities (Note 11)	1,475,520
TOTAL LIABILITIES	\$ <u>6,291,205</u>
Commitments and Contingencies (Note 12)	
NET POSITION	
Unexpended Appropriations - Other Funds (Note 15)	\$ 11,017
Cumulative Results of Operations - Other Funds (Note 15)	35,652,709
TOTAL NET POSITION	\$ <u>35,663,726</u>
TOTAL LIABILITIES AND NET POSITION	\$ <u>41,954,931</u>

The accompanying notes are an integral part of the statements.

Department of Defense
 DEPARTMENT OF THE NAVY WORKING CAPITAL FUND
CONSOLIDATED STATEMENT OF NET COST

For the Year Ended September 30, 2018
 (\$ in Thousands)

	Unaudited 2018 Consolidated
Program Cost	
Gross Cost	\$ 38,730,201
Less: Earned revenue	<u>(35,244,122)</u>
Net Cost of Operations	<u><u>\$ 3,486,079</u></u>

The accompanying notes are an integral part of the statements.

Department of Defense
DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Year Ended September 30, 2018
(\$ in Thousands)

	Unaudited 2018 Consolidated
UNEXPENDED APPROPRIATIONS	
Beginning Balance	\$ 1,531
BUDGETARY FINANCING SOURCES	
Total Budgetary Financing Sources	9,486
Total Unexpended Appropriations	\$ 11,017
CUMULATIVE RESULTS OF OPERATIONS	
Beginning Balances	\$ 35,307,832
Prior Period Adjustments:	
Changes in Accounting Principles (Note 15)	(3,242)
Beginning Balances, as adjusted	\$ 35,304,590
BUDGETARY FINANCING SOURCES	
Nonexchange Revenue	1,374
Other budgetary financing sources	(36)
OTHER FINANCING SOURCES	
Transfers In/Out without Reimbursement	876,951
Imputed Financing	645,883
Other	2,310,026
Total Financing Sources	3,834,198
Net Cost of Operations	3,486,079
Net Change	348,119
Cumulative Results of Operations	\$ 35,652,709
Net Position	\$ 35,663,726

The accompanying notes are an integral part of the statements.

Department of Defense
DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2018
(\$ in Thousands)

	Unaudited 2018 Combined
Budgetary Resources:	
Unobligated Balance from Prior Year	
Budget Authority, Net (Discretionary and Mandatory)	\$ 3,414,262
Appropriations	9,486
Contract Authority	12,084,623
Spending Authority from Offsetting Collections	23,694,942
Total Budgetary Resources	\$ 39,203,313
Net Adjustment to Unobligated Balance Brought Forward, Oct. 1	\$ 468,759
Material Adjustments to Unobligated Balance Brought Forward	
Status of Budgetary Resources:	
New Obligations and Upward Adjustments	\$ 35,915,983
Unobligated Balance, End of Year	
Apportioned	3,149,603
Exempt from apportionment, unexpired accounts	1,696
Unapportioned	136,031
Unexpired Unobligated Balance, End of Year	3,287,330
Expired Unobligated Balance, End of Year	-
Unobligated Balance Brought Forward, End of Year	3,287,330
Total Status of Budgetary Resources	\$ 39,203,313
Outlays, Net:	
Agency Outlays, Net	\$ (242,935)

The accompanying notes are an integral part of the statements.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Mission of the Reporting Entity

The Department of the Navy (DON) was established on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12) with an overall mission to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

The DON is a complex organizational entity comprised both of subordinate organizations as well as other entities which are administratively aligned to the DON mission, but funding for those operations is provided by external reporting entities.

The DON has elected to utilize SFFAS No. 47, "Reporting Entity" as the basis to organizationally define the financial reporting entities within the DON, and then to use Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, "Entity and Display" as the basis for applying budget accounts to the financial reporting entities. The financial results of operations are presented within three separate Annual Financial Reports (AFRs) for the United States Navy (USN) GF, the United States Marine Corps (USMC) GF, and the DON (USN and USMC) Working Capital Fund. The USMC GF and USN GF financial results are not reported in this AFR.

A more detailed description of the DON WCF reporting entity as well as descriptions and missions of the DON WCF consolidation entities can be found in the Organization and Mission section of Management's Discussion and Analysis.

1.B. Basis of Presentation

These financial statements have been prepared to report non-comparative financial position, net costs of operations, changes in net position and combined budgetary resources of the DON WCF, as required by the *Chief Financial Officers (CFO) Act of 1990*, expanded by Title IV of the *Government Management Reform Act (GMRA) of 1994*, and other appropriate legislation. The financial statements have been prepared from the books and records of the DON WCF in accordance with, and to the extent possible, U.S. generally accepted accounting principles (U.S. GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements;" and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the DON WCF is responsible unless otherwise noted.

The DON WCF financial statements will only present current year results of its operations, the financial position, the changes in the financial position, and the combined budgetary resources. Prior year financials are unreliable and changes from the prior year are misleading and do not reflect a true indication of business-driven fluctuation.

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The DON financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of DON WCF Commands. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, *Federal Employees' Compensation Act (FECA)* liabilities and environmental liabilities. Some of the Command level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated DON WCF level, these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed to prevent the disclosure of classified information. Information specific to classified assets, programs, and operations are aggregated and reported in such a manner that it is not discernible.

The DON is unable to implement all elements of U.S. GAAP, OMB Circular No. A-136, and *Federal Financial Management Improvement Act of 1996 (FFMIA)* due to limitations of financial and nonfinancial management processes and systems that support the financial statements. These limitations are noted throughout the financial statements as applicable. The DON derives reported values and information for major asset and liability categories from both financial and nonfinancial systems. The nonfinancial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with U.S. GAAP. The DON continues to implement process and system improvements to address these limitations.

Specifically, the DON WCF is not in compliance with the following authoritative accounting guidance:

- SFFAC No. 7, “Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording”
- SFFAS No. 3, “Accounting for Inventory and Related Property”
- SFFAS No. 5, “Accounting for Liabilities of the Federal Government”
- SFFAS No. 4, “Managerial Cost Accounting Concepts and Standards for the Federal Government”
- SFFAS No. 6, “Accounting for Property, Plant, and Equipment”
- SFFAS No. 7, “Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting”
- SFFAS No. 10, “Accounting for Internal Use Software”
- SFFAS No. 12, “Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government”
- SFFAS No. 44, “Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use”
- SFFAS No. 48, “Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials”
- SFFAS No. 50, “Establishing Opening Balances for General Property, Plant, and Equipment”
- SFFAS No. 55, “Amending Inter-entity Cost Provisions”
- Treasury Financial Manual,
- Federal Financial Management Improvement Act (FFMIA) of 1996
- Government Management Reform Act (GMRA) of 1994

1.C. Appropriations and Funds

The DON WCF received its initial funding through the establishment of a corpus which was provided through an appropriation. Annually, the DON WCF receives limited appropriated dollars and is primarily funded through contract authority, and spending authority from offsetting collections. Contract authority represents authority that permits DON WCF to incur obligations in advance of an appropriation, offsetting collections, or receipts to make outlays to liquidate the obligations. Spending authority from offsetting collection represent authority that permits obligations and outlays to be financed by offsetting collections.

The DON WCF obtains the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the DON WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

1.D. Use of Estimates

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported amounts of revenue and expenses during the reporting period. These estimates and assumptions include, but are not limited to, environmental disposal liabilities, accounts payable, contingent legal liabilities, allowance for doubtful accounts, and allowance for inventory held for repair. Accordingly, actual results may differ from those estimates as of the date of the financial statements.

1.E. Revenues and Other Financing Sources

The DON WCF has five business areas: Depot Maintenance, Research and Development, Transportation, Base Support, and Supply Management. The DON WCF Depot Maintenance activities recognize revenue according to the percentage of completion method. Research and Development DON WCF activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Transportation DON WCF activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects accrue revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.

Supply Management DON WCF activities recognize revenue from the sale of inventory items. The DON WCF recognizes revenue when earned within the constraints of its current system capabilities. In many instances, revenue is recognized

when bills are issued and when the revenue is earned. Due to these limitations, the DON WCF is not compliant with SFFAS 7.

The DON WCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 17, "Reconciliation of Net Cost of Operations to Budget." The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

The DON WCF records donations in trust funds and special funds as nonexchange revenue. The DON WCF recognizes nonexchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not receive value in return. These revenues are presented on the Statement of Change in Net Position and recognize as part of budgetary financing sources.

1.F. Recognition of Expenses

For financial reporting purposes, U.S. GAAP requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis; therefore, the DON WCF performs data calls to obtain and record financial amounts to include expenses to its financial accounting system. Estimates are made for major items, such as payroll expenses, accounts payable, FECA liabilities, environmental liabilities, contingent legal liabilities, and unbilled revenue.

Imputed financing represents the costs paid on behalf of the DON WCF by another federal entity. The DON WCF recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include unemployment and workers' compensation under FECA; and (3) losses in litigation proceedings; and (4) military payroll for service members assigned to the DON.

The DON WCFs proportionate share of public debt and related expenses of the federal government is not included. The federal government does not apportion debt and its related costs to federal agencies. Generally, financing for the construction of DON WCF facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized, as the U.S. Treasury does not allocate such costs to DON WCF. Accordingly, the DON WCFs financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

In the case of operating materials & supplies (OM&S), an operating expense is generally recognized when items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses to better aligned with SFFAS No. 3 "Accounting for Inventory and Related Property." Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, some expenditures for capital and other long-term assets may be recognized as operating expenses. The DON WCF continues to implement process and system improvements to address these limitations. The valuation methods for OM&S are not supported.

1.G. Accounting for Intragovernmental Activities

Accounting standards require an entity to eliminate intra-entity, and trading partner activity and balances from consolidated financial statements to prevent overstatement for business with itself, except for the Statement of Budgetary Resources. However, DON WCF cannot accurately identify intragovernmental transactions (revenues, expenses, accounts receivable, accounts payable, and non-expenditure transfers) by customer, as DON WCF systems do not track buyer and seller data at the transaction level; therefore increasing the risk that all eliminating entries have not been recorded. Generally, seller entities within the DON WCF provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DON WCF seller-side balances and are then eliminated. The DON WCF is implementing replacement systems and a standard financial information structure incorporating the necessary elements to enable the DON WCF to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual (TFM) Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," provides guidance for reporting and reconciling intragovernmental balances. While DON WCF is unable to reconcile intragovernmental transactions with all federal agencies, DON WCF can reconcile

balances pertaining to FECA transactions with the Department of Labor (DOL) and benefit program transactions with the Office of Personnel Management. The DON WCF is taking actions to reconcile intragovernmental transactions with all federal agencies.

1.H. Funds with the U.S. Treasury

The DON WCF's monetary resources are maintained in U.S. Treasury accounts. The DON WCF generally does not maintain cash in commercial bank accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), Department of the Navy, the other military departments, and the Department of State's financial service centers process the majority of the DON WCF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes.

In addition, DFAS and the USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable fund balance with treasury (FBWT) account. Monthly, the DON WCF's FBWT is reconciled at the subhead or business project area level prior to closing the field general ledger (GL) systems. The reconciliations identify the population of transactions comprising the variance between the GL and Defense Cash Accountability System (DCAS), which contains transaction level Treasury details. The reconciliations serve as the support for monthly FBWT adjustments. FBWT variances identified after the GL systems have closed each month are addressed through adjustments entered during the financial reporting process completed in the Defense Departmental Reporting System (DDRS). The DDRS level FBWT adjustments, as required, ensure financial statements agree with the U.S. Treasury accounts. Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.I. Accounts Receivable

Accounts receivable consist of amounts owed to the DON by other Federal agencies and the public. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," the methodology for losses due to uncollectible amounts from the public is based on an individual account analysis and group analysis. The analysis is based on three years of receivable data. The DON WCF uses non-federal data to determine the historical percentage of collections in each age category of public receivables. Additionally, the DON recognizes an allowance for all non-intragovernmental accounts receivable which are 120 days delinquent.

The DON WCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies and deems all intragovernmental accounts receivable as fully collectible in accordance with the TFM Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules" and recognizes that this methodology does not comply with SFFAS 1.

1.J. Inventory and Related Property

The DON WCF categorize inventory and related property as inventory and operating materials and supplies (OM&S). Due to long standing financial system deficiencies, the DON WCF is unable to implement SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials." The DON WCF is currently implementing corrective action plans that will remediate these deficiencies and will permit the DON WCF to establish opening balances for Inventory and OM&S in accordance with SFFAS No. 48.

SFFAS No. 3 defines supply management inventory as a tangible personal property that is available and purchased for sale, held for repair, excess, obsolete, and unserviceable, and work in process. DON WCF assigns inventory to categories based upon condition of the inventory item; and in the case of raw material and work in process (WIP), based upon stage of fabrication.

Inventory, Net

Available and purchased for sale inventory is defined as inventory used in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. Available and purchased for sale inventory includes consumable and reparable spare and repair parts and repairable items owned and managed by the DON WCF. Available and purchased for sale also include items for sale or transfer to entities outside the federal

government or other federal entities. The DON WCF recognizes inventory when title passes to the DON WCF or when the goods are delivered to the DON WCF.

Held in for reserve for future sale inventory consists of additional consumable and repairable items held in reserve for future sale as it is not readily available for immediate sale. Held for repair inventory consists of damaged materiel that requires repair to make it usable. Inventory that is Excess Obsolete and Unserviceable consist of items that exceeds the amount expected to be used; is no longer needed because of changes in technology, laws, customs, or operations; or is damaged physically and cannot be consumed in operations.

The DON WCF values available and purchased for sale inventory using the Latest Acquisition Cost (LAC), or Moving Average Cost (MAC) methods as outlined in SFFAS No 3. The DON WCF values held for repair inventory at the price of a serviceable item, less estimated repair costs, using the direct method. When the DON WCF completes the repair, the cost of repair is capitalized in the asset account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

Operating Materials and Supplies, Net

The DON WCF identifies related property as OM&S. The DON WCF OM&S is categorized as operating material and supplies held for use, held for repair and excess, obsolete, and unserviceable. The DON WCF holds OM&S based on military/mission need and support for contingencies. Refer to Note 6, "Inventory and Related Property, Net" for additional information.

Due to long standing financial system deficiencies, the DON WCF is unable to implement SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials." The DON WCF uses a combination of the Consumption Method and Purchases Method to account for OM&S in accordance with SFFAS No. 3. Under the consumption method, the DON WCF capitalized OM&S upon purchase and expensed it when it is consumed. Under the purchase method, material and supplies are expensed when purchased. Individual components in the DON WCF use the consumption method unless the OM&S they maintain is (1) not material, (2) in the hands of the end user or, (3) if it is not cost-beneficial to apply the consumption method.

The DON WCF standard valuation method for OM&S is MAC. However, some OM&S is valued using the Latest Acquisition Cost (LAC). The LAC method is used for OM&S accounted for in the DON WCF legacy logistics (feeder) systems or Accountable Property Systems of Record (APSR) that were designed specifically for material management rather than accounting purposes. The DON WCF is in the process of resolving these weaknesses and transitioning to the MAC method.

1.K. General Property, Plant, and Equipment

Due to long standing financial system deficiencies, the DON WCF is not compliant with SFFAS No. 50, "Establishing Opening Balances for General Property, Plant, and Equipment" in valuing historical general PP&E or, SFFAS No. 6, "Accounting for Property, Plant and Equipment". The DON WCF is currently implementing corrective action plans that will remediate these deficiencies and will permit the DON WCF to establish an opening balance for all general PP&E in accordance with SFFAS No. 50. The DON WCF has established an opening balance for general equipment.

The DON WCF will continue to implement SFFAS No. 6, as it relates to new General PP&E. The DON WCF uses estimated historical cost for valuing equipment. To establish a baseline, the DON WCF accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition, and disposal information. In FY 2018, the DON WCF released a policy directing assets awaiting disposal to be revalued and reclassified. This ceases depreciation and revalues the asset at its NRV, recognizes any clean-up cost liability, and establishes a record for PP&E that are "permanently removed but not yet disposed of." As of September 30, 2018, the DON WCF has not revalued any PP&E awaiting disposal and it is reported in the general PP&E note disclosure as opposed to other assets. Refer to Note 7, "General Property, Plant, and Equipment."

The DON WCF has elected to apply the provisions of SFFAS No. 50 to land and land rights. The DON WCF excluded (expensed) its land and land rights from the general PP&E reported balance. Future land and land rights will be expensed

in accordance with SFFAS No. 50. The disclosed acreage for land cannot be relied upon until the DON WCF improves its business processes around existence and completeness. Refer to Note 7, "General Property, Plant, and Equipment, Net" for further information.

The DON WCF capitalizes PP&E at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The DON WCF capitalizes improvements to existing PP&E if the improvement equals or exceeds the DON WCF's capitalization threshold, extends the useful life of the underlying asset, or increases asset size, efficiency, or capacity. The DON WCF depreciates all PP&E, other than land, on a straight-line basis.

The DON WCF PP&E and internal use software (IUS) capitalization threshold is \$250 thousand. The threshold applies to acquisitions and modifications/improvements placed into service after September 30, 2013. The DON WCF capitalized PP&E acquired prior to October 1, 2013 at lower threshold levels (\$100 thousand for general equipment and \$20 thousand for real property) and are carried at the remaining net book value. The DON WCF capitalizes all PP&E used in the performance of their mission in accordance with their Capital Purchase Program (CPP) procedures. In this case, DON WCF assets are capitalized as PP&E, whether or not they meet the definition of any other PP&E category.

When it is in the best interest of the government, the DON WCF provides government property to contractors to complete contract work. The DON WCF either owns or leases such property or it is purchased directly by the contractor on government-based contract terms. The Federal Acquisition Regulation (FAR) requires the DON WCF maintain information on all property furnished to contractors in its property systems when the value of contractor-procured PP&E meets or exceeds the DON WCF capitalization thresholds, federal accounting standards require that it be reported on DON WCF's balance sheet. The DON WCF has not complied with the FAR requirements and is in the process of developing a business process to record and track all contractor held property in DON WCF property system.

1.L. Advances and Prepayments

When payments made in advance of the receipt of goods and services is permitted by law, legislative action, or presidential authorization, DON's policy is to record advances or prepayments as an asset on the Balance Sheet. Upon receipt of the related goods and services, the DON's policy is to reduce the advances and prepayments and properly classify the assets. The DON has not implemented this policy due to noncompliance with the *Federal Financial Management Improvement Act of 1996*.

1.M. Other Assets

Other assets include military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on DON WCF's Balance Sheet. Advances are outlays made by the DON to its employees, contractors, or others to cover a part or all of the recipients' anticipated expenses. Civilian pay advances are payments advanced to full-time DON civilians intended to finance unusual employee expenses associated with oversea assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips. Travel advances are subsequently reduced when travel expenses are incurred.

The DON WCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DON WCF may provide financing payments. Contract financing payments are defined in the FAR, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the government. The DON WCF has not implemented this policy primarily due to system limitations. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost reimbursement contracts.

1.N. Contingencies and Other Liabilities

The DON WCF is party to various administrative proceedings, legal actions, and claims. A contingency is defined as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The

uncertainty will be resolved when one or more future events occur or fail to occur. The DON WCF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The DON WCF's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as vehicle accidents; medical malpractice; property or environmental damages; and contract disputes. Refer to Note 10, "Environmental Disposal Liabilities" for additional information.

Other liabilities also arise because of anticipated disposal costs for the DON WCF's assets. Consistent with SFFAS No. 6, recognition of an anticipated environmental disposal liability begins when the asset is placed into service.

Nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. Due to noted deficiencies in 1.K, DON WCF is not able to reconcile the population of real property assets that encompass the environmental sites closure and asbestos liabilities.

1.O. Accrued Leave

The DON WCF reports unused compensatory and civilian annual leaves as accrued liabilities as it is earned. The accrued balance is adjusted annually to reflect current pay rates and unused hours of leave. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. For the unfunded liability, the DON WCF will request supplemental appropriation through Congress for infusion of funding to cover these costs. Sick leave for civilians is expensed as taken.

1.P. Net Position

Net position consists of unexpended appropriations and cumulative results of operations.

Unexpended appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.Q. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections recorded in the general ledger and those reported by the U.S. Treasury. Supported undistributed disbursements and collections have corroborating documentation for the summary level adjustments made to accounts payable and receivable. Unsupported undistributed disbursements and collections do not have supporting documentation for the transactions and most likely would not meet audit scrutiny. However, both supported and unsupported adjustments may have been made to DON WCF accounts payable and accounts receivable prior to validating underlying transactions and would most likely not pass audit scrutiny.

Due to noted material weaknesses in current accounting and financial feeder systems, the DON WCF generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly. Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.R. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's actuarial liability for workers' compensation benefits is developed by the DOL and provided to the DON at the end of each fiscal year. Military retirement is accounted for in the financial statements of the Retirement Fund. As such, DON WCF does not record any liabilities or obligations for pensions or healthcare retirement benefits. Refer to Note 13, "Federal Employee and Veteran Benefits" for additional information.

1.S. Tax Exempt Status

As an agency of the federal government, the DON is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

NOTE 2. NONENTITY ASSETS

As of September 30	Unaudited 2018
(Amounts in thousands)	
Accounts Receivable, with the Public, Net	\$ 5,271
Total Entity Assets	\$ 41,949,660
Total Assets	\$ 41,954,931

Nonentity assets are assets for which the DON WCF maintains stewardship, accountability, and reporting responsibility but are not available for the DON WCF's normal operations.

Nonfederal accounts receivable with the public represent interest, penalties, fines and administrative fees that will be remitted to the Treasury's miscellaneous receipts account.

NOTE 3. FUND BALANCE WITH TREASURY

Status of Fund Balance With Treasury

As of September 30	Unaudited 2018
(Amounts in thousands)	
Unobligated Balance	
Available	\$ 3,151,299
Unavailable	136,031
Obligated Balance not yet Disbursed	18,510,863
Non-FBWT Budgetary Accounts	(19,275,068)
Total	\$ 2,523,125

The Status of FBWT reflects the budgetary resources to support the FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable balance primarily relates to research and development funding. Certain unobligated balances are restricted for future use and are not apportioned for current use.

Obligated balance not yet disbursed represents funds that have been obligated for goods and services not received and those received but not paid.

Since Non-FBWT budgetary accounts do not post to fund balance with treasury and budgetary status accounts simultaneously, certain adjustments to presentation are required to reconcile the budgetary status to non- budgetary fund balance with treasury as reported in the accompanying Balance Sheet. Non-FBWT budgetary accounts is comprised of

contract authority (\$4,371.6 million), accounts receivable (\$1,126.2 million), and unfilled orders without advance from customers (\$13,777.2 million) for the DON WCF.

Due to business process and system limitations, the DON field-level general ledger accounting systems may not include all Treasury collection and disbursement activity for reasons such as timing differences, transaction distribution errors and disbursements made by other DoD agencies on behalf of the DON.

Due to business process and system limitations, the DON does not record disbursements in transit.

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30	Unaudited 2018		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
Intragovernmental Receivables	\$ 1,079,965	\$ -	\$ 1,079,965
Nonfederal Receivables (From the Public)	95,876	(43,198)	52,678
Total	<u>\$ 1,175,841</u>	<u>\$ (43,198)</u>	<u>\$ 1,132,643</u>

Accounts receivable represents the DON WCF's claim for payment from other entities. Intragovernmental receivables represent amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. In the intragovernmental eliminations process, buyer-side accounts receivables are adjusted to agree with inter/intra-agency seller-side accounts payables. Claims with other federal agencies are considered fully collectable in accordance with the Intragovernmental Business Rules.

Nonfederal accounts receivable is mainly held with Naval Facilities Engineering Command and Naval Supply Systems Command. As of September 30, 2018, the DON WCF only recognizes an allowance for uncollectible amounts from the public. The methodology used in determining the allowance amount is discussed in Note 1.I, "Accounts Receivable." Refer to Note 2, "Nonentity Assets," for additional information on nonfederal accounts.

NOTE 5. OTHER ASSETS

As of September 30	Unaudited 2018
(Amounts in thousands)	
Outstanding Contract Financing Payments	\$ 781,783
Advances and Prepayments	745,629
Other Assets (With the Public)	1,072
Total Nonfederal Other Assets	<u>1,528,484</u>
Total	<u>\$ 1,528,484</u>

Nonfederal Other Assets - Outstanding Contract Financing Payments (OCFP)

Nonfederal other assets OCFP consist of contract terms and conditions for certain types of contract financing payments that convey rights to the DON WCF, protecting the contract work from state or local taxation, liens or attachment by contractors' creditors, transfer of property, or disposition in bankruptcy. However, these rights do not mean that ownership of the contractor's work has transferred to the DON WCF. The DON WCF does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON WCF is not obligated to make payment to the contractor until delivery and acceptance. As a result, cash outlays and payments are made by the DON WCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. OCFP are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

Nonfederal Other Assets - Advances and Prepayments

Advances are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity will receive. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Nonfederal Other Assets - Other Assets (With the Public)

Nonfederal other assets (with the public) consists of prepayments made to vendors and travel advances made to employees.

NOTE 6. INVENTORY AND RELATED PROPERTY

As of September 30	Unaudited 2018
(Amounts in thousands)	
Inventory, Net	\$ 34,566,402
Operating Materials & Supplies, Net	210,894
Total	<u>\$ 34,777,296</u>

Inventory and Related Property

Unaudited 2018				
As of September 30	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
(Amounts in thousands)				
Inventory, Net				
Inventory Categories				
Available and Purchased for Resale	\$ 18,610,078	\$ 65,351	\$ 18,675,429	LAC, MAC
Held in for Reserve for Future Sale	873,302	-	873,302	LAC, MAC
Held for Repair	15,032,659	(49,303)	14,983,356	LAC, MAC
Raw Materiel	34,315	-	34,315	LAC, MAC
Total	<u>\$ 34,550,354</u>	<u>\$ 16,048</u>	<u>\$ 34,566,402</u>	

Legend for Valuation Methods:

LAC = Latest Acquisition Cost MAC = Moving Average Cost

The DON WCF inventory and related property consist of inventory and operating materials and supplies.

Inventory consists of funded and reported materials held for sale or as inventory stock, under the DON WCF. All DON inventory held for sale is funded and reported on the DON WCF financial statements.

The DON WCF classifies its inventory in four categories based on purpose or condition: available and purchased for sale, held in for reserve for future sale, held for repair, and raw material. Raw materials are the cost or value of raw materials purchased or donated for use as a component part of inventory. Excess, obsolete, and unserviceable inventory is valued at zero and is not reported.

There are currently no restrictions on the use, sale, or disposition of inventory except in the following situations:

1) distributions without reimbursement are made when authorized by DoD directives; 2) war reserve materiel includes repair items that are considered restricted; and 3) inventory, except for safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

DON WCF inventory is disposed of in accordance with the Resource Conservation and Recovery Act (RCRA) of 1979 and Federal Facility Compliance Act (FFCA) of 1992, which requires that munitions be reviewed periodically and a determination be made as to suitability for use and potential to be deemed hazardous waste.

Due to business process and system limitations, there are unreconciled balances between the DONs APSRs, Navy Enterprise Resource Planning (Navy ERP) records, and Defense Logistics Agency (DLA)-held supply management

inventory. As a result, the DON WCF recorded an allowance for available and purchased for sale in the amount of \$99 million; which represents the unreconciled balance as of September 30, 2018, and caused the abnormal balance reported in the amount of \$65.4 million. The WCF inventory held for repair balance within Navy-ERP omitted impaired inventory assets returned by customers due to system limitations. A \$3.2 billion upward adjustment was recorded to estimate the impaired inventory amount returned by customers.

Operating Materials and Supplies, Net

Unaudited 2018			
As of September 30	OM&S Gross Value	OM&S, Net	Valuation Method
(Amounts in thousands)			
OM&S Categories			
Held for Use	\$ 210,471	\$ 210,471	MAC
Held for Future Use	423	423	MAC
Total	\$ 210,894	\$ 210,894	

Legend for Valuation Methods:

MAC = Moving Average Cost

The DON WCF OM&S consists of tangible personal property in support of general maintenance on Navy facilities such as paint, screws, bolts, etc.

The DON WCF classifies its OM&S in two categories based on purpose or condition: held for use, and held for future use. Held for use consists of all other serviceable (ready for issue) material. OM&S held for future use are items not readily available in the market and there is a more than a remote chance that they will eventually be needed for future use. Held for future use also consists of damaged material, accounted for in the physical inventory, that is more economical to repair than to dispose. Excess, obsolete, and unserviceable OM&S is valued at zero and is not reported.

There are no known restrictions on the use of OM&S.

NOTE 7. GENERAL PROPERTY, PLANT, AND EQUIPMENT, NET

Unaudited 2018					
As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in thousands)					
Major Asset Classes					
Buildings, Structures, Linear Structures, and Utilities	S/L	20 or 40	\$ 6,033,793	\$ (4,951,711)	\$ 1,082,082
Software	S/L	2-5 or 10	170,760	(127,977)	42,783
General Equipment	S/L	5 or 10	2,948,810	(2,377,236)	571,574
Construction-in-Progress	N/A	N/A	296,134	-	296,134
Other	M	M	810	-	810
Total General PP&E			\$ 9,450,307	\$ (7,456,924)	\$ 1,993,383

Legend for Valuation Methods:

S/L = Straight Line N/A = Not Applicable M = Multiple

The DON WCF's general PP&E is comprised of unique asset lifecycle-based categories consisting of: buildings, structures, linear structures and utilities (real property); software; general equipment (GE); and construction-in-progress (real property and GE). Other general PP&E consists of assets awaiting disposal.

The DON WCF has elected to apply the provisions of SFFAS No. 50 to land and land rights and therefore the current year balance of land is zero.

The DON uses land, buildings, and other overseas facilities obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the DON continued use of these properties until the treaties expire.

There are no known restrictions on the use or convertibility of PP&E.

NOTE 8. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	Unaudited 2018
(Amounts in thousands)	
Intragovernmental Other Liabilities	
Other	\$ 124,244
Federal Employee and Veteran Benefits	627,406
Environmental Liabilities	372,883
Total Nonfederal Liabilities	<u>\$ 1,000,289</u>
Total Liabilities Not Covered by Budgetary Resources	\$ 1,124,533
Total Liabilities Covered by Budgetary Resources	<u>\$ 5,166,672</u>
Total Liabilities	<u><u>\$ 6,291,205</u></u>

Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources includes liabilities for which congressional action is needed before budgetary resources can be provided to cover the liabilities. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Liabilities – Other

Other intragovernmental liabilities consist of unfunded FECA liabilities due to the Department of Labor and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Nonfederal Liabilities

Federal employee and veteran benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities represent the FECA actuarial liabilities that will be funded in future periods. Refer to Note 13, "Federal Employee and Veteran Benefits," for additional details and disclosures.

Environmental liabilities are estimates related to future events, and consist of liabilities related to active installations, equipment and weapons programs, and chemical weapons disposal. See Note 10, "Environmental and Disposal Liabilities," for additional details and disclosures.

NOTE 9. ACCOUNTS PAYABLE

Unaudited 2018			
As of September 30	Accounts Payable		Total
(Amounts in thousands)			
Intragovernmental Payables	\$	258,001	\$ 258,001
Nonfederal Payables (to the Public)		3,260,475	3,260,475
Total	\$	3,518,476	\$ 3,518,476

Accounts payable includes amounts owed to federal and nonfederal entities for goods and services received by the DON WCF. The DON WCF's systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payable are adjusted to agree with inter/intra-agency seller-side accounts receivable. The DON WCF's methodology for adjusting accounts payables consist of (1) reclassifying amounts between federal and nonfederal accounts payable; (2) accruing additional accounts payable and expenses; and (3) applying both supported and unsupported undistributed disbursements at the reporting entity level. Refer to Note 1.Q, "Undistributed Disbursements and Collections" for additional information.

The DON WCF is continuing to record accrual entries to account for federal accounts payable. These accrual entries are completed to record the estimated amount of cost incurred and goods or services received but not invoiced.

Accounts payable also consists of estimated future contracting financing payments consist of contract terms and conditions for certain types of contract financing payments that convey certain rights to the DON protecting the contract work from state or local taxation, liens or attachment by the contractors' creditors, transfer of property, or disposition in bankruptcy. However, these rights do not mean that ownership of the contractor's work has transferred to the DON. The DON does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON is not obligated to make payment to the contractor until delivery and acceptance.

NOTE 10. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30	Unaudited 2018	
(Amounts in thousands)		
Environmental Liabilities - Nonfederal		
Other Accrued Environmental Liabilities - Non-BRAC		
Environmental Closure Requirements	\$	221,837
Asbestos		149,619
Non-Military Equipment		1,427
Total	\$	372,883

The DON WCF reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of general PP&E assets. Such costs are categorized as environmental corrective action, closure of facilities, remediation of operational range contamination, asbestos abatement, and disposal of non-military equipment. The remaining environmental liabilities are reported under the DON General Fund Financial Statements.

Applicable Laws and Regulations for Cleanup Requirements

The following is a list of significant laws that affect the DON's conduct of environmental policy and regulations:

- Superfund Amendments and Reauthorization Act (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Atomic Energy Act
- Nuclear Waste Policy Act
- Low Level Radioactive Waste Policy Amendments Act
- Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)

- Medical Waste Tracking Act
- Toxic Substances Control Act (TSCA)
- Resource Conservation and Recovery Act (RCRA)
- National Environmental Policy Act of 1969
- Medical Waste Tracking Act of 1988
- Financial Management Regulation Volume 4, Chapter 13: “Environmental and Disposal Liabilities” (April 2018)
- Statement of Federal Financial Accounting Standards 6: Accounting for Property, Plans, and Equipment
- Statement of Federal Financial Accounting Standards 5: Accounting for Liabilities of the Federal Government
- DoD FMR, Volume 6B, Chapter 10, Notes to the Financial Statements
- Federal Financial Accounting and Auditing Technical Release 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government Page 2 of 27
- Federal Financial Accounting Technical Release 10, Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment
- Federal Financial Accounting Technical Release 11, Implementation Guidance on Cleanup Costs Associated with Equipment
- Federal Financial Accounting Technical Release 14, Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment
- Federal Accounting Standards Advisory Board (FASAB) Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Cost, amended by FASAB under Technical Bulletin 2011-2, Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Costs

Description of the Types of Environmental and Disposal Liabilities Identified

Other Accrued Environmental Liabilities – Non-BRAC

The OEL segment prepares accounting estimates for the unique clean-up costs that will be incurred when DON WCF PP&E assets are decommissioned. The estimate is only prepared for those assets determined to have unique cleanup costs associated with hazardous waste or materials at the time of decommissioning. This includes estimates of environmental cleanup costs upon asset closure, addressing hazardous waste, asbestos, and lead, in addition to mandated cleanup of petroleum residuals and lubricants, these estimates are recognized as cleanup costs to current operating procedures. The OEL segment also reports estimated costs to remediate existing environmental damage at active DON WCF facilities, when such costs are not eligible for funding from DERP.

The DON WCF's estimated recognized environmental cleanup cost for PP&E totaled \$373 million as of September 30, 2018. For closure sites, non-military equipment and asbestos-abatement units placed in service after a threshold date, only part of estimated costs is immediately recognized as an environmental liability. The un-accrued portion of such estimates is reported as unrecognized costs. The DON WCF's unrecognized environmental cleanup cost for PP&E totaled \$23.6 million as of September 30, 2018.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

The OEL program relied on a historic fence to fence survey and currently relies on multiple APSRs to derive and recognize liabilities associated with the decommissioned assets over real property and general equipment-remainder. These APSRs include: internet naval facilities data storage system (iNFADs), navy enterprise resource planning (N-ERP), and defense property accountability system (DPAS). On an annual basis, APSRs are reviewed and updated to the inventory are captured for estimation purposes. Environmental conditions that result from current operations and require immediate cleanup (like oil spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expenses, if fully remediated within the current fiscal year.

Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities

The environmental liabilities for the DON WCF are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation

to a different degree than when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

At this time, the DON WCF estimates asbestos clean-up costs (friable and non-friable) for property, plant, and general equipment via extrapolation of historical costs and cost estimates for similar real property considered to be reasonable.

Nature of Estimates and the Disclosure of Additional Information

Estimated environmental liabilities are extremely complex with various input factors. In addition, these input factors are adjusted for new technology, price growth (inflation), increases in labor rates and materials. As of September 30, 2018, there are no changes to the environmental liability estimates due to inflation, deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The DON WCF is not aware of any pending changes, but the liability can change in the future due to changes in laws and regulations, inflation, deflation, changes in agreements with regulatory agencies, and advances in technology.

NOTE 11. OTHER LIABILITIES

As of September 30	Unaudited 2018		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
Intragovernmental			
Advances from Others	\$ 103,693	\$ -	\$ 103,693
FECA Reimbursement to the Dept of Labor	56,343	67,901	124,244
Custodial Liabilities	5,271	-	5,271
Employer Contribution and Payroll Taxes Payable	63,712	-	63,712
Total Intragovernmental	229,019	67,901	296,920
Accrued Funded Payroll and Benefits	1,090,882	-	1,090,882
Advances from Others	373,340	-	373,340
Deposit Funds and Suspense Accounts	1,222	-	1,222
Contract Holdbacks	5,543	-	5,543
Employer Contribution and Payroll Taxes Payable	4,957	-	4,957
Other Liabilities	(424)	-	(424)
Total Other Liabilities	\$ 1,704,539	\$ 67,901	\$ 1,772,440

Advances from others represent liabilities for collections received to cover future expenses or acquisition of assets.

FECA Reimbursement to the Department of Labor represent the liabilities chargeback amount for payments made by DOL on the behalf of DON WCF. The DON WCF recognized \$56.3 million of chargeback liability to DOL as of September 30, 2018.

Custodial liabilities represent liabilities for collections reported as nonexchange revenues where the DON WCF is acting on behalf of another federal entity. Based on guidance in SFFAS No. 31, "Accounting for Fiduciary Activities," the statement of custodial activity is not required as part of the DON WCF's financial statements as balances that would be reported on the statement of custodial activity are reflected on the DON WCF's balance sheet.

Nonfederal Liabilities

Accrued funded payroll and benefits represents the estimated liability for salaries and wages of civilians that have been earned but are unpaid and amounts of funded annual leave, sick leave, and other employee benefits that have been earned but unpaid.

Through research and analysis, the DON WCF has revised its business process on how to account for estimated future contracting financing payments associated with the OCFP. This resulted in a reclassification of \$73 million to CIP and AP. Refer to Note 9, "Accounts Payable", for further information.

Nonfederal other liabilities are attributed to improperly recorded unfunded liability transactions in the field accounting system. The posting issues creating this condition have been documented to support identification and prioritization of corrective action.

NOTE 12. COMMITMENTS AND CONTINGENCIES

The DON WCF is a party in various administrative proceedings, legal actions, and claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON WCF accrues contingent legal liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. Additional information about the DON WCF contingent legal liabilities can be found in Note 11, "Other Liabilities."

The DON WCF OGC and Office of Judge Advocate General (OJAG) conduct reviews of litigation and claims threatened or asserted involving DON WCF to which the OGC and OJAG attorneys devoted substantial attention in the form of legal consultation or representation. For each claim above the annual assessment materiality threshold, OGC and OJAG assess the likelihood of an unfavorable outcome, as follows: probable, remote, and reasonably possible, as outlined in accordance with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." As of September 30, 2018, the DON WCF materiality threshold for reporting litigation, claims, or assessments was \$20 million.

As of September 30, 2018, the DON WCF has one case that exceeded the materiality threshold. The DON has assessed this case as reasonably possible with a potential loss of \$28 million.

In addition to legal cases managed by the OGC and OJAG, DON's Office of Civilian Human Resources (OCHR) manages U.S. Equal Employment Opportunity Commission (EEOC) cases presented against the DON. EEOC case liability is not included in the contingent legal liability calculation amount, as the maximum exposure of these cases, individually and collectively, are not significant.

The DON WCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolutions, that may result in a future outflow of expenditures. Currently, the DON WCF's automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present DON WCF's commitments and contingencies.

NOTE 13. FEDERAL EMPLOYEE AND VETERAN BENEFITS

Unaudited 2018			
As of September 30	Liabilities		Unfunded Liabilities
(Amounts in thousands)			
Other Actuarial Benefits			
FECA	\$	627,406	\$ 627,406

The DON WCF reports an actuarial liability for the FECA. The FECA provides federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation.

The FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. The FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used and Assumptions

The DON WCF's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON WCF only at the end of each fiscal year. The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

The DOL calculates the future workers' compensation liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year 2018 were also used to adjust the methodology's historical payments to current year constant dollars. To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Changes in the liability from last year's analysis to the year's analysis were also examined by agency, with any significant differences by agency inspected in greater detail. DOL concluded that the model has been stable and has projected the actual payments by agency as well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.7% was assumed for year one, year two, and thereafter. An interest rate for medical benefits of 2.4% was assumed for year one, year two, and thereafter.

NOTE 14. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Intragovernmental Costs and Exchange Revenue

As of September 30	Unaudited 2018
(Amounts in thousands)	
Intragovernmental Costs	\$ 6,197,412
Nonfederal Costs	\$ 32,532,789
Gross Costs	\$ 38,730,201
Intragovernmental Revenue	(27,543,649)
Nonfederal Revenue	(7,700,473)
Less: Earned Revenue	(35,244,122)
Total Net Cost	\$ 3,486,079

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the DON WCF. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The WCF nonfederal gross costs balance within Navy-ERP included excessive costs of goods sold amounts related to assets returned by customers due to system limitations. A \$3.2 billion downward adjustment was recorded to estimate the excessive cost of goods sold amount related to impaired inventory assets returned by customers.

Intragovernmental costs and revenue represent transactions made between two reporting entities within the federal government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The DON WCF's financial management systems do not track intragovernmental transactions by customer. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and nonfederal expenses. Intradepartmental revenues and expenses are then eliminated.

NOTE 15. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

The Statement of Changes in Net Position (SCNP) reports the change in net position during the reporting period. Net position is affected by changes to its two components: cumulative results of operations and unexpended appropriations.

Other financing sources - other consists primarily of gains and losses associated with general equipment, operating materials & supplies, and real property. Cumulative results of operations represent the net results of operations since inception. Included as a reduction in cumulative results of operations are accruals for which related expenses require funding from future appropriations. These future funding requirements include, among others (a) accrued annual leave earned but not taken, (b) expenses for contingent liabilities and (c) expenses for environmental liabilities.

Transfers in/out without reimbursement are recorded at book value of the transferring entity, or if unknown, is the amount the estimated fair value at the date of transfer.

Unexpended appropriations represent the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn. As of September 30, 2018, the DON WCF received \$9.5 million in appropriated monies from the Bipartisan Budget Act of 2018, Public Law 115-123. The change in accounting principle represents an adjustment to write-off land values in accordance with SFFAS 50.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30	Unaudited 2018
(Amounts in thousands)	
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 15,051,773

Disclosures Related to the Statement of Budgetary Resources

As of September 30	Reimbursable Obligations	Total
(Amounts in thousands)		
Obligations Apportioned Under		
Category A	\$ -	\$ -
Category B	\$35,915,983	\$35,915,983
Exempt	-	-
Total	\$ 35,915,983	\$ 35,915,983

The statement of budgetary resources includes intra-entity transactions because the statement is presented as combined.

Undelivered Orders at the End of the Period

Due to system limitations and business process, the DON is unable to properly categorize its undelivered orders between federal and non-federal.

Available Borrowing and Contract Authority

Borrowing authority represents authority that DON WCF is permitted to incur obligations and outlays to be financed by borrowing. Contract authority represents authority that permits DON WCF to incur obligations in advance of an appropriation, offsetting collections, or receipts to make outlays to liquidate the obligations. As of September 30, 2018, there is \$39.2 billion in total budgetary resources including \$12.1 million in contract authority.

Apportionment Categories for Obligations Incurred

The direct and reimbursable obligations under Categories A, B, and Exempt from apportionment are reported in the table below. Apportionment categories are determined in accordance with the guidelines provided in Part 4 "Instructions on Budget Execution" of OMB Circular A-11 Preparation, Submission and Execution of the Budget. Category A represents resources apportioned for calendar quarters and Category B represents resources apportioned for other time periods or for activities, projects, objectives, or for a combination thereof.

NOTE 17. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30	Unaudited 2018
(Amounts in thousands)	
Resources Used to Finance Activities	
Budgetary Resources Obligated:	
Obligations Incurred	\$ 35,915,983
Less: Spending Authority from Offsetting Collections and Recoveries	(35,229,505)
Net Obligations	686,478
Other Resources:	
Transfers In/Out without Reimbursement	876,951
Imputed Financing from Costs Absorbed by Others	645,883
Other	2,310,026
Net Other Resources Used to Finance Activities	3,832,860
Total Resources Used to Finance Activities	\$ 4,519,338
Resources Used to Finance Items not Part of the Net Cost of Operations	
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:	
Undelivered Orders	\$ (2,728,642)
Unfilled Customer Orders	1,908,626
Resources that Fund Expenses Recognized in Prior Periods	(52,435)
Resources that Finance the Acquisition of Assets	(5,589,479)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:	
Other	(3,231,278)
Total Resources Used to Finance Items not part of the Net Cost of Operations	(9,693,208)
Total Resources Used to Finance the Net Cost of Operations	\$ (5,173,870)
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	
Components Requiring or Generating Resources in Future Period:	
Increase in environmental and disposal liability	\$ 70,107
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	70,107
Components not Requiring or Generating Resources:	
Depreciation and Amortization	324,492
Revaluation of Assets or Liabilities	1,172,176
Other	
Cost of Goods Sold	10,632,371
Other	(3,539,197)
Total Components of Net Cost of Operations that will not Require or Generate Resources	8,589,842
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	8,659,949
Net Cost of Operations	\$ 3,486,079

The reconciliation of net cost of operations to budget is designed to reconcile the net cost of operations reported in the Statement of Net Cost to the current year obligations reported in the Statement of Budgetary Resources. This reconciliation is required due to the inherent in timing and recognition differences between the accrual accounting method used to calculate net cost and the budgetary accounting method used to calculate budgetary resources and obligations.

Due to the DON WCF financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency. Because of these system limitations, resources that finance the acquisition of assets on the reconciliation of net cost of operations to budget were adjusted upward by \$1.0 billion as of September 30, 2018 to bring it into balance with the SNC. The adjustments were recorded in components of the net cost of operations not requiring or generating resources in the current period.

The following reconciliation of net cost of operations to budget lines are presented as combined instead of consolidated as intra-entity budgetary transactions are not eliminated:

- Obligations Incurred
- Spending Authority from Offsetting Collections and Recoveries

- Obligations Net of Offsetting Collections and Recoveries
- Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Resources used to finance activities - other, is presented as the net increase to inventory for the period. The DON is working to resolve the business postings for in-transit inventory that are creating distortions in the reported revenues and expenses.

Resources used to finance items not part of net cost of operations - other, are amounts related to supply management of inventory available and purchased for sale including consumable spare and repair parts and reparable items as well as goods transferred for reissue from inventory.

Components not requiring or generating resources - other, consists of applied overhead and cost capitalization offset. These balances represent overhead costs distributed to work in process and costs transferred to an "in-process" asset accounts such as construction in progress.

NOTE 18. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

The DON WCF collected \$37.7 million of incidental custodial revenues generated primarily from surcharges, interest, penalties, fines and administrative fees. These funds are not available for use by the DON WCF. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.



A guided-missile destroyer transits the Strait of Gibraltar. (U.S. Navy photo by Mass Communication Specialist 3rd Class Jonathan Clay/Released)



DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

OTHER INFORMATION

Sailors secure a torpedo while loading ammunition aboard a guided missile cruiser. (U.S. Navy photo by Petty Officer 2nd Class William McCann)



TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT*Restatement: No*

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Balance	General Fund	Working Capital Fund
Financial Statement Compilation and Reporting	0	2	0	0	2	1	1
Fund Balance with Treasury	0	2	0	0	2	1	1
Accounts Payable	0	1	0	0	1	1	0
Government Property in the Custody of Contractors	0	1	0	0	1	1	0
General PP&E – Real Property	0	2	0	0	2	1	1
General PP&E – General Equipment – Remainder	0	2	0	0	2	1	1
General PP&E – General Equipment – Valuation	0	1	0	0	1	1	0
Construction in Process	0	2	0	0	2	1	1
Inventory	0	1	0	0	1	0	1
Operating Materials and Supplies – Remainder	0	1	0	0	1	1	0
Ordnance	0	1	0	0	1	1	0
Oversight and Monitoring	0	2	0	0	2	1	1
Total Material Weaknesses	0	18	0	0	18	11	7

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES*The DON Financial Reporting Material Weaknesses and Corrective Actions*

End-to-End Process	Areas of Material Weaknesses	Beginning Balance*	New	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Budget-to-Report	Fund Balance with Treasury	1	-	-	-	1	1	1
	Financial Statement Reporting and Compilation	6	-	-1	-	5	5	3
Hire-to-Retire	Military Pay	1	-	-	-	1	1	-
Procure-to-Pay	Contract/ Vendor Pay	3	-	-1	-	2	2	1
	Reimbursable Work Orders (Budgetary)	1	-	-	-	1	1	1
	Transportation of Things	2	-	-	-1*	1	1	1
Acquire-to-Retire	Equipment Assets	1	-	-	-	1	1	1
	Real Property Assets	1	-	-	-	1	1	1
Plan-to-Stock	Inventory	1	-	-	-	1	1	1
	Operating Materials and Supplies	1	-	-	-	1	1	-
	Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures)	2	-	-1	-	1	1	-
Multiple End-to-End Processes	Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures)	1	-	-	-	1	1	1
	Reimbursable Work Orders (Budgetary)	2	-	-	-	2	2	2
	Financial Statement Reporting and Compilation	1	-	-	-	1	1	1
Total Financial Reporting Material Weaknesses		24	0	-3	-1	20	20	14

*Unauthorized use of transportation account codes (TAC) was downgraded to a control deficiency as TACs are not material to the DON.

The DON Operational Material Weaknesses

Effectiveness of Internal Controls over Non-Financial Operations (FMFIA § 2)

Statement of Assurance: Modified Assurance

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Comptroller and Resource Management	1	-	-	-	1	1	1
Contract Administration	1	-	-	-	1	1	1
Security	1	-	-	-	1	1	1
Manufacturing, Maintenance, and Repair	1	-	-	-	1	1	1
Personnel and Organizational Management	1	1	-	-	2	2	-
Force Readiness	0	1	-	-	1	1	-
Information Technology	0	1	-	-	1	1	1
Multiple Reporting Categories	0	1	-	-	1	1	1
Total Material Weaknesses	5	4	0	0	9	9	6

Financial Management Systems Material Weakness/Nonconformances and Corrective Actions

Effectiveness of Internal Controls over Financial Systems (FMFIA § 4 and FFMIA)

Statement of Assurance: Controls are not in place to provide Reasonable Assurance

Nonconformances	Beginning Balance	New	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Financial Management Systems	8	-	-3	-	5	5	5
Total System Conformance Material Weaknesses	8	-	-3	-	5	5	5

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

	Agency	Auditor
1. Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2. Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. USSGL at Transaction Level	Lack of compliance noted	Lack of compliance noted

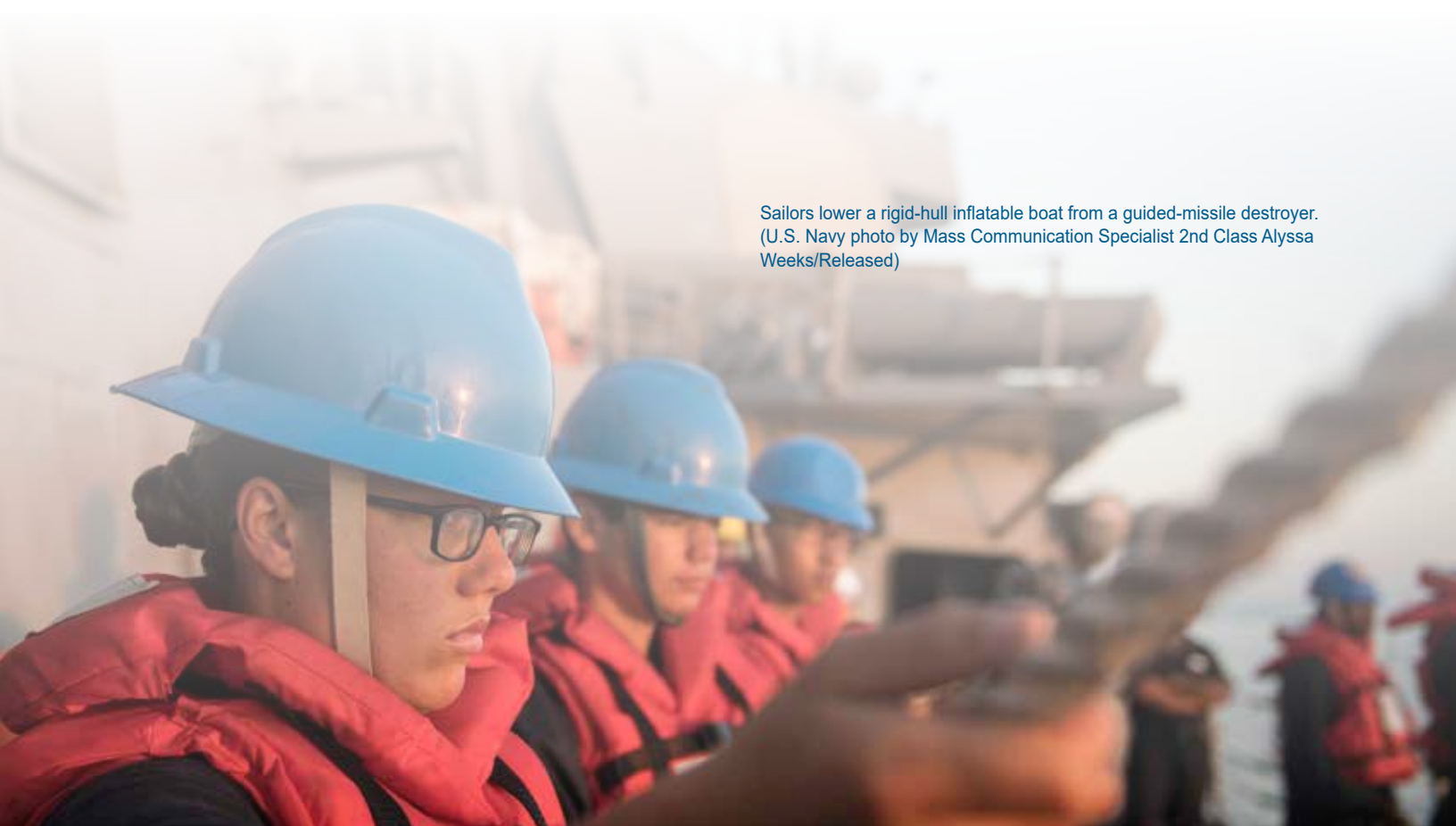


Writing in the deck log aboard a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist 2nd Class Alyssa Weeks/Released)



APPENDIX

Sailors lower a rigid-hull inflatable boat from a guided-missile destroyer.
(U.S. Navy photo by Mass Communication Specialist 2nd Class Alyssa Weeks/Released)



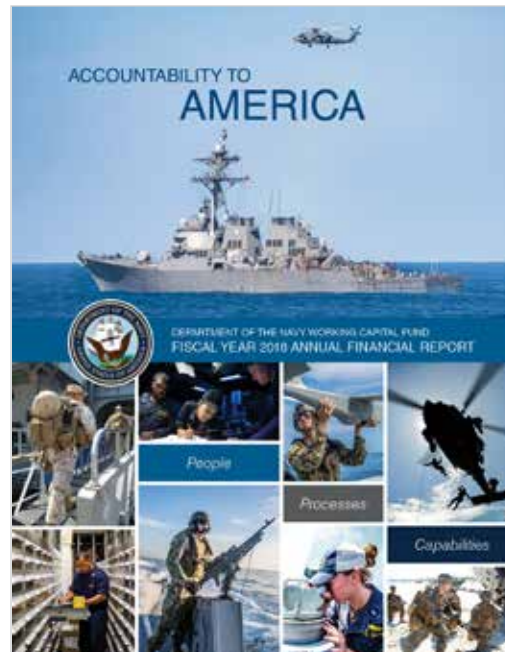
Acronym	Definition
AFR	Annual Financial Report
AI	Artificial Intelligence
AMRAAM	Advanced Medium Range Air-to-Air Missile
AO	Action Officer
APSR	Accountable Property System of Record
ARG	Amphibious Ready Groups
ASN (FM&C)	Assistant Secretary of the Navy, Financial Management & Comptroller
ASN (RD&A)	Assistant Secretary of the Navy, Research, Development, & Acquisition
ASVAB	Armed Services Vocational Aptitude Batter
BRAC	Base Closure and Realignment Commission
BSO	Budget Submitting Office
BUMED	Bureau of Medicine and Surgery
BUPERS	Bureau of Naval Personnel
CAD/PAD	Cartridge Activated Device/Propellant Activated Device
CANES	Consolidated Afloat Networks and Enterprise Services
CAP	Corrective Action Plan
CFO	Chief Financial Officer
CIP	Construction in Process
CIP	Career Intermission Program
CMC	Commandant of the Marine Corps
CMU	Carnegie Mellon University
CNIC	Commander, Navy Installations Command
CNO	Chief of Naval Operations
CNRF	Commander, Navy Reserve Force
CO	Commanding Officers
COLA	Cost of Living Adjustment
COMPACFLT	Commander, U.S. Pacific Fleet
COMUSFLTFORCOM	U.S. Fleet Forces Command
CPIM	Consumer Price Index Medical
CRE	Component Reporting Entity
CRSSRT	National Center for Research on Evaluation, Standards and Student Testing
CSG	Carrier Strike Group
CSMP	Current Ships' Maintenance Plan
CYBERCOM	Cyber Command
DDNI	Deputy Director of Naval Intelligence
DDRS	Defense Departmental Reporting System
DDRS-AFS	Defense Departmental Reporting System-Audited Financial Statements (AFS).
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DIU	Defense Innovation Unit
DM&R	Deferred Maintenance and Repair
DNI	Director of Naval Intelligence
DNS	Director, Navy Staff
DoD	Department of Defense
DoD FMR	Department of Defense Financial Management Regulation
DoDIG	Department of Defense Inspector General
DOL	Department of Labor
DON	Department of the Navy
DON/AA	Department of the Navy Assistant for Administration
DPIA	Docking Planning Incremental Availability
DWO	Navy's Digital Warfare Office
EEOC	Equal Employment Opportunity Commission
EFTM	External Fuel Transfer Module
EPF	Expeditionary Fast Transports
ERP	Enterprise Resource Planning
ESSM	Evolved Sea Sparrow Missile
EXWC	Engineering and Expeditionary Warfare Center
FAR	Federal Acquisition Regulations

Acronym	Definition
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FCI	Facility Condition Index
FEC	Naval Facilities Engineering Service Center
FECA	Federal Employees' Compensation Act
FFCA	Federal Facility Compliance Act
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement and Audit Readiness
FID	Fixed Induction Date
FISCAM	Federal Information System Controls Audit Manual
FISWG	Financial Information Systems Working Group
FLC	Fleet Logistics Center
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulation
FRC	Fleet Readiness Centers
FSA	Field Support Activity
FTE	Full Time Equivalent
FY	Fiscal Year
GF	General Fund
GLs	General Ledger systems
GLS	Global Logistics Support
GMRA	Government Management Reform Act of 1994
HA/DR	Humanitarian Assistance and Disaster Relief
HQMC	Headquarter, Marine Corps
ICO	Internal Controls over Operations
ICOFR	Internal Controls Over Financial Reporting
ICOFS	Internal Controls Over Financial Systems
IMC	Integrated Maintenance Concept
IPA	Independent Public Accounting
IRR	Individual Ready Reserve
IT	Information Technology
JFCC IMD	Joint Functional Component Command for Integrated Missile Defense
JOIN	Job Opportunities in the Navy
LAC	Latest Acquisition Cost
LCS	Littoral Combat Ships
LPD	Amphibious Transport Dock
MAC	Moving Average Cost
MAP	Meritorious Advancement Program
MARFORCOM	U.S. Marine Corps Forces Command
MARFORCYBER	U.S. Marine Corps Forces, Cyberspace Command
MARFORPAC	U.S. Marine Corps Forces, Pacific
MARFORRES	U.S. Marine Corps Forces Reserve
MARFORSOC	U.S. Marine Corps Forces, Special Operations Command
MAU	Major Assessable Unit
MCICOM	Marine Corps Installations Command
MCLC	Marine Corps Logistics Command
MEF	Marine Expeditionary Force
MICCN	Monash Institute of Cognitive and Clinical Neurosciences
MICP	Managers' Internal Control Program
MNCC	MyNavy Career Center
MOIP	Monitoring OsseoIntegrated Prostheses
MPN	Military Personnel Navy
MPT&E	Manpower, Personnel, Training, & Education
MRR	Marine Raider Regiment
MRSG	Marine Raider Support Group
MSC	Military Sealift Command
MSOS	Marine Special Operations School
MW	Material Weakness
NAMCE	Naval Aviation Maintenance Center of Excellence
NAS	Naval Air Station
NAVAIR	Naval Air Systems Command

Acronym	Definition
NAVFAC	Naval Facilities Engineering Command
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
NAWC	Naval Air Warfare Center
NCIS	Naval Criminal Investigative Service
NDAA	National Defense Authorization Act
NDS	National Defense Strategy
NETC	Naval Education Training Command
NIA	Naval Intelligence Activity
NIST	National Institute of Standards and Technology
NPS	Naval Postgraduate School
NRC	Navy Recruiting Command
NRL	Naval Research Laboratory
NSMA	Navy Systems Management Activity
NSWC	Naval Special Warfare Command
NSWC	Naval Surface Warfare Center
NUWC	Naval Undersea Warfare Center
NWC	Naval War College
OCFP	Outstanding Contract Financing Payments
OCHR	Office of Civilian Human Resources
OCO	Overseas Contingency Operations
OCONUS	Outside Continental United States
OGC	Office of General Counsel
OJAG	Office of the Judge Advocate General
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget
ONR	Office of Naval Research
OSD	Office of Secretary of Defense
PAO	Principal Administering Office
PEO	Program Executive Office
PIEE	Process to Improve Expenditure Efficiency
PM	Program Managers
PMA	Phased Maintenance Availability
PMI	Planned Maintenance Intervals
PP&E	Property, Plant, & Equipment
R&D	Research and Development
RCRA	Resource Conservation and Recovery Act
RIMPAC	Rim of the Pacific Exercise
RMF	Risk Management Framework
RPN	Reserve Personnel Navy
RRL	Ready Relevant Learning
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
S&T	Science and Technology
S/L	Straight Line
SAO	Senior Accountable Officials
SAP	Special Access Programs
SAT	Senior Assessment Team
SBA	Schedule of Budgetary Activity
SBR	Statement of Budgetary Resources

Acronym	Definition
SCNP	Statement of Changes in Net Position
SD	Significant Deficiencies
SDBII	Small Diameter Bomb Increment II
SEAL	Special Warfare Operators
SECDEF	Secretary of Defense
SECNAV	Secretary of the Navy
SECNAVINST	Secretary of the Navy Instructions
SES	Senior Executive Service
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Senior Management Council
SMS	Sustainment Management System
SNC	Statement of Net Cost
SNTWI	Secretary of the Navy Tours with Industry
SOA	Statement of Assurance
SOF	Special Operations Forces
SPAWAR	Space and Naval Warfare Systems Command
SSC	Space and Naval Warfare Systems Center
SSGN	Guided Missile Submarine
SSN	Nuclear Attack Submarines
SSP	Strategic Systems Program
STARS-FL	Standard Accounting and Reporting System – Field Level
SURTASS	Surveillance Towed-Array Sensor System
TFM	Treasury Financial Manual
TI	Treasury Index
TNC	Treasury Nominal Coupon
TU	Transaction Universe
U.S.	United States of America
UCC	Unified Combatant Command
USACE	U.S. Army Corps of Engineers
USAFRICOM	United States Africa Command
USCENTCOM	United States Central Command
USCYBERCOM	United States Cyber Command
USEUCOM)	United States European Command
USFK	U.S. Forces Korea
USGAAP	U.S. Generally Accepted Accounting Principles
USMC	United States Marine Corps
USN	United States Navy
USNORTHCOM	United States Northern Command
USPACOM	U.S. Pacific Command
USPACOM	United States Pacific Command
USSGL	U.S. Standard General Ledger
USSOCOM	U.S. Special Operations Command
USSOCOM	United States Special Operations Command
USSOUTHCOM	United States Southern Command
USSTRATCOM	United States Strategic Command
USTRANSCOM	United States Transportation Command
WCF	Working Capital Fund
WSS	Weapons Systems Support





1. An MH-60R Sea Hawk helicopter approaches a class guided-missile destroyer during a vertical replenishment. (U.S. Navy photo by Mass Communication Specialist 3rd Class Morgan K. Nall/Released)
2. Marines board a Nimitz-class aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 3rd Class Matt Herbst/Released)
3. Sailors assigned to a guided-missile destroyer participate in a naval surface fire support drill. (U.S. Navy photo by Mass Communication Specialist 2nd Class Anita C. Newman/Released)
4. A Quarter Master mans the M240 machine gun aboard MKVI patrol boat as it escorts a fleet replenishment oiler. (U.S. Navy photo by Chief Boatswain's Mate Nelson Doromal Jr/Released)
5. Preparing an unmanned aerial vehicle for launch aboard a patrol boats in the Pacific Ocean. Navy photo by Chief Petty Officer Nelson Doromal Jr.
6. Sailors rappel from an MH-60S Seahawk helicopter to a flight deck. (U.S. Navy photo by Petty Officer 3rd Class Alex Corona)
7. Taking inventory of supplies aboard a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist 2nd Class Devin M. Langer/Released)
8. Taking a bearing as a guided-missile destroyer conducts a replenishment-at-sea with a Military Sealift Command fleet replenishment oiler. (U.S. Navy photo by Mass Communication Specialist 2nd Class Devin M. Langer/Released)
9. U.S. Marines participate in beach landing exercises. (U.S. Navy photo by Mass Communication Specialist 1st Class Adam C. Stapleton/Released)



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For More Information

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